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STRUGGLING OVER RISK. SOLIDARITY AND RESPONSIBILITY IN THE EUROSYSTEM

PIETER-AUGUSTIJN VAN MALLEGHEM*

Abstract

Risk sharing practices within the Eurosystem raise the architectural question of the appropriate degree of solidarity and responsibility among the central banks participating in the system. In the euro area, the implementation of monetary policy is typically decentralized. Whereas this is of little significance when the losses of individual NCBs are shared by the Eurosystem as a whole, when individual NCBs remain responsible for the losses they incur, the credibility of euro area monetary policy and, in extreme scenarios, even the survival of the euro area as a whole may be endangered. This article surveys the constitutional rules applicable to risk sharing and maps the diverse landscape of risk distribution in monetary policymaking within the Eurosystem. The article claims that the central pillar of risk policy in the euro area – a default rule in favour of loss sharing among NCBs – violates both the letter and spirit of the ESCB Statute as written and shows how this gives rise to significant distributive struggles within the Eurosystem. The conclusion provided is that a decentralized implementation of monetary policy constitutes a significant source of fragility for the euro area.

1. Introduction

It is commonplace to lament the asymmetric nature of European Monetary and Economic Integration. While considerable effort has been dedicated to creating substantial budgetary capacity at the level of the euro area, perhaps culminating in the Union's NextGenerationEU initiative, the decentralization of the EMU's monetary pillar and the weaknesses it may engender often remain overlooked. This article argues that the decentralization of monetary policy in the euro area remains an important source of fragility. While the

* Professor of EU Law, University of Louvain (UCLouvain), Louvain-la-Neuve, Belgium. This work is supported by an ERC Starting Grant (FEDMONEY, project no 1010754110). Funded by the European Union. Views and opinions expressed are, however, those of the author only and do not necessarily reflect those of the European Union or the European Research Council. Neither the European Union nor the granting authority can be held responsible for them.

Eurosystem's risk distribution practices remain shrouded in relative secrecy, they simultaneously raise significant legal questions and lie at the heart of distributive struggles with considerable stakes between the Eurosystem's monetary actors. This raises the architectural question of the appropriate degree of solidarity and responsibility of the central banks participating in the Eurosystem.

This article examines how the law and policy of the Eurosystem distributes risks. It introduces the legal framework for central bank decentralization and the architectural question it raises with respect to risk sharing (Section 2). It goes on to examine the constitutional framework that applies to the distribution of risk in the Eurosystem and the limits it imposes on the discretion of the Governing Council of the European Central Bank (ECB) (Section 3). In spite of the Union's institutional practice to shroud these mechanisms in relative secrecy (Section 4), this article maps the risk distribution practices of the Eurosystem with respect to its most significant policies (Section 5) and the attempts to transform the applicable constitutional framework (Section 6). The article closes with a conclusion (Section 7).

2. Monetary decentralization and its effects

Although monetary policy in the euro area is an exclusive competence of the EU,[1] the constitutional framework of monetary union supports the decentralization of its implementation (Section 2.1). The practice raises an architectural question for the euro area: what is the correct balance between the solidarity and the responsibility of participating central banks (Section 2.2)?

2.1. *Decentralized central banking*

There is an oxymoron at the heart of euro area monetary policy: a central bank, so the name suggests, ought to be centralized – yet that is precisely what the Eurosystem is not. In fact, the ECB is but the tip of the iceberg: it is both at the centre of the European System of Central Banks, which reunites all national central banks of the EU, and at the heart of the Eurosystem, which groups the central banks of the members of the euro area.[2] (Because this article concerns the euro area, the focus will be on the latter.) The Governing Council of the

1. Consolidated Version of the Treaty on the Functioning of the European Union [2012] OJ C326/49, Art 3(c) (TFEU).
2. Ibid, Art 282(1).

ECB defines the monetary policy for the euro area.[3] But the implementation of Eurosystem monetary policy is typically decentralized.[4] The ESCB Statute provides that '[t]o the extent deemed possible and appropriate…, the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB'.[5] NCBs must indeed 'act in accordance with the guidelines and instructions of the ECB',[6] thereby guaranteeing the singleness of euro area monetary policy.[7] Because of the hierarchical nature of the relationship between the ECB and the NCBs, some prefer the term 'decisional centralism'[8] or 'indirect implementation'[9] to 'decentralization', to describe the relationship between them. NCBs nevertheless occasionally have a margin of discretion in the implementation of Eurosystem monetary policy.[10] It is disputed whether the Statute requires decentralization under all circumstances. Elsewhere, the Statute indeed provides that the 'ECB shall ensure that the tasks conferred upon the ESCB… are implemented *either* by its own activities pursuant to this Statute *or* through the national central banks…',[11] suggesting that the ECB has discretion in implementing monetary policy itself or in delegating it to the NCBs. Nevertheless, monetary decentralization is what the Eurosystem typically practices and can take several forms. Most often, the euro area NCBs collectively implement Eurosystem monetary policy.[12] In what is called 'selective decentralization',[13] selected NCBs undertake monetary policy operations on behalf of the Eurosystem as a whole.

3. Ibid, Art 282(2).
4. Carel C A van den Berg, *The Making of the Statute of the European System of Central Banks* (Dutch UP 2005) 111–112; Rosa Maria Lastra, 'The Division of Responsibilities between the European Central Bank and the National Central Banks within the European System of Central Banks' (2000) 6 Colum J Eur L 167, 172. See also Carel C A van den Berg, 344.
5. Statute of the European System of Central Banks (annex to TFEU), Art 12.1 at the end (ESCB Statute).
6. Ibid, Art 14.3.
7. TFEU, Art 119(2).
8. Chiara Zilioli and Martin Selmayr, *The Law of the European Central Bank* (Hart Publishing 2001) 67.
9. Ibid, 113 et seq, especially 118.
10. See, for example with regard to the additional credit claims, text accompanying n 100.
11. ESCB Statute, Art 9.2 (emphasis added).
12. See, for example, with respect to main refinancing operations, Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (ECB/2014/60) (recast), Art 6.2(e) (General Documentation Guideline).
13. Matthias Mayer, *Die Verteilung von Verlusten aus der Offenmarktpolitik des Eurosystems. Kompetenzielle Grundlagen und unionsrechtliche Grenzen* (Mohr Siebeck 2022) 250.

2.2. *An architectural question: Solidarity or responsibility?*

Monetary decentralization has significant economic consequences. Although the ECB draws up a consolidated balance sheet of the Eurosystem,[14] neither the Eurosystem nor the European System of Central Banks have legal personality, though the ECB and the NCBs do.[15] The execution of Eurosystem monetary policy by euro area NCBs is done at their own risk.[16]

The consequences of the design choice to let NCBs operate at their own risk are considerable. Imagine, for example, that a significant financial crisis affects the euro area as a whole. The ECB decides to lower interest rates across the board. Yet in one Member State, the banking system has made a significant number of non-performing loans, resulting in a number of bankruptcies among banking institutions. Or imagine that the ECB decides that NCBs must buy the sovereign bonds of their own sovereigns outright and that financial markets subsequently price in a high likelihood of sovereign bankruptcy of one euro area Member State. In both cases, the NCB of that particular Member State would incur significant risks. If the financial health of the relevant NCB was already in bad shape prior to such an event, would the NCB in question be able to survive? And what would the implications be for the euro area as a whole?

Monetary decentralization spells trouble when central banks incur losses. Monetary policymaking always implies a risk of losses for the central banks concerned,[17] because the objective of the European System of Central Banks is price stability[18] rather than avoiding potential losses. Yet it is unclear whether losses matter much in the case of central banks. Central banks are indeed unique in that they have been known, historically, to operate while sustaining losses. The Bundesbank, today often perceived as an anchor of stability, operated with negative equity during the 1970s and 1980s.[19] The

14. ESCB Statute, Art 26.3.

15. TFEU, Art 282(3) in conjunction with ESCB Statute, Art 9.1. See also van den Berg (n 4) 38, 43–45 and Zilioli and Selmayr (n 8) 64.

16. Euro area NCBs then 'become the creditors of the counterparties as the collateral taker[…], the debtors as regards the deposit operations[…] and the owners of purchased assets as regards outright purchases'. See Heidfeld, 'Article 18: Open Market and Credit Operations' in Helmut Siekmann (ed), *The European Monetary Union. A Commentary on the Legal Foundations* (Hart Publishing 2022) 938.

17. See generally European Central Bank, 'The financial risk management of the Eurosystem's monetary policy operations – July 2015' (Publications Office of the European Union 2015). This sentiment is echoed by the Court. Case C-62/14, *Peter Gauweiler v Deutscher Bundestag*, EU:C:2015:400, para 125.

18. TFEU, Art 127.

19. Julian Langner, 'Preliminary notes to Articles 28-33' in Siekmann (n 16) 1118; Julian Langner, 'Article 33: Allocation of net profits and losses of the ECB' in Siekmann (n 16) 1249.

Czech central bank also sustained significant losses for a decade after its establishment in the 1990s.[20] But not all central banks have been successful in weathering such a storm, as the bankruptcies of central banks in Zimbabwe or the Philippines demonstrate.[21] Sceptics therefore object that, although central banks may in theory operate with negative capital, their losses can interfere with their capacity to combat inflation – a scenario dubbed 'policy insolvency'.[22] Depending on the likelihood of excess inflation, recapitalization may be desirable.[23] This is typically done by the government backing the central bank in question. The ECB itself appears to be of two minds on the issue. ECB President Lagarde agrees that 'by definition the ECB will neither run out of liquidity nor fail'.[24] Simultaneously, its legal service maintains that Eurosystem losses can undermine its 'financial and functional independence'.[25]

In the euro area, these questions arise in the peculiar context of a supranational central bank without a centralized fiscal authority. As former ECB President Draghi points out, 'each monetary policy operation always has some fiscal implication… Usually, these fiscal implications are dealt with easily within a one-country framework, between the central bank and the treasury. But in the euro area, there is no European treasury, and each national treasury gives an implicit or explicit indemnity to its own central bank, but not the euro system as a whole'.[26] When an NCB is in need of recapitalization, the

20. Jan Frait and Tomáš Holub, 'Exchange rate appreciation and negative central bank capital: is there a problem?' in Sue Milton and Peter Sinclair (eds), *The Capital Needs of Central Banks* (Routledge 2011) 107, 1113.

21. Peter Stella and Åke Lönnberg, 'Issues in Central Bank Finance and Independence' (2008) IMF Working Paper 2008/037; Willem Buiter, 'Can Central Banks Go Broke?' (2008) CEPR Policy Insight 24/2008.

22. ibid.

23. Peter Stella, 'Do Central Banks Need Capital?' (1997) IMF Working Paper 1997/083.

24. Letter from the ECB President to Ms Manon Aubry MEP on monetary policy <ecb.europa.eu/pub/pdf/other/ecb.mepletter201229_Aubry~82873a5b54.en.pdf> (all websites last visited 13 December 2024).

25. Case T-79/13 *Alessandro Accorinti v European Central Bank* EU:T:2015:756, para 86. In this regard, the ECB's website also reports that 'it is important to remember that central banks are not like ordinary companies. They can lose money and still operate effectively. Still, the principle of financial independence implies that national central banks should be sufficiently capitalised'. See ECB, 'Profits and losses of the ECB and the euro area national central banks: where do they come from?' (*Explainers*, 19 May 2023) <ecb.europa.eu/ecb-and-you/explainers/tell-me-more/html/ecb_profits.en.html>. See also Section 6.2 below.

26. Mario Draghi, President of the ECB, 'Introductory statement to the press conference (with Q&A)' (Frankfurt am Main, 22 January 2015) <ecb.europa.eu/press/press_conference/monetary-policy-statement/2015/html/is150122.en.html>. See also Ulrich Bindseil, Marco Corsi, Benjamin Sahel and Ad Visser, 'The Eurosystem collateral framework explained' (2017) ECB Occasional Paper Series 189/2017, 10 <www.ecb.europa.eu/pub/pdf/scpops/ecb.op189.en.pdf> ('Central banks 'ultimately manage "public" money and their losses are at the expense

lack of a European treasury may indeed be a source of fragility for the Eurosystem itself.

The loss sharing regime in the Eurosystem therefore raises an architectural question with significant distributive stakes.[27] On the one hand, the Eurosystem could emphasize the individual responsibility of each NCB, refusing to share losses (though profits could still be shared in the form of a 'community of benefits'[28] only). Individual NCBs would be forced to internalize any loss associated with its monetary policy operations. When losses are significant, this can threaten the credibility of the NCB in question. The NCB might have to be saved by its Member State government. It has been argued that the lack of risk sharing creates an 'existential threat' for the euro area: 'the risk that – despite the consolidated Eurosystem being solvent – one or more of the NCBs could become insolvent and cannot be recapitalized by their national sovereign(s)'.[29] In such a case, cooperation between euro area NCBs might grind to a halt because of distrust among NCBs, causing concern for the survival of the euro area not unlike that at the peak of the eurozone crisis.

The polar alternative would emphasize solidarity among its NCBs by socializing losses. It would then be a 'community of loss-sharing'.[30] Any losses incurred by one NCB are externalized to the system as a whole. All euro area fiscal authorities – as opposed to a single national fiscal authority – then provide an implicit fiscal backstop to any and all NCBs suffering losses, and thereby to Euro area monetary policy as a whole. In such a scenario, it is unclear whether monetary decentralization matters at all. The matter is particularly striking in the context of Eurosystem purchases of public debt of the Member States (but by no means only in this context). As former Bundesbank governor Jens Weidmann puts it, when losses are shared:

of the taxpayer'). These remarks reveal the significance of the chartalist tradition for the euro area. See generally Charles A E Goodhart, 'The two concepts of money: implications for the analysis of optimal currency areas' (1998) 14 Europ J Pol Econ 407, 409.

27. See generally Loïc Azoulai, 'Editorial comments: A jurisprudence of distribution for the EU' (2022) 59 CML Rev 957. See also David Kennedy, *A World of Struggle: How Power, Law, and Expertise Shape Global Political Economy* (Princeton UP 2016).

28. See, by analogy, Edoardo Chiti and Pedro Gustavo Teixeira, 'The constitutional implications of the European responses to the financial and public debt crisis' (2013) 50 CML Rev 683, 697 and Ton van den Brink and Matteo Gargantini, 'Models of Solidarity in the EMU. The impact of COVID-19 after Weiss' (2021) 17 Utrecht LR 80, 82 et seq (describing the 'fiscal union' model).

29. Willem Buiter, 'The Euro Area: Monetary Union or System of Currency Boards?' (*Global Economics View*, 19 March 2015) <willembuiter.com/sharing.pdf>.

30. See, by analogy, Chiti and Teixeira (n 28) 697 and van den Brink and Gargantini (n 28) 97 and the following (on the model of 'individual fiscal responsibility').

> '…government bond purchases involve the fundamental risk of mutualizing sovereign liability risks via the central bank's balance sheet. While this risk can be more or less ignored for countries with their own currency, it can be a major problem for a monetary union – especially so for one which, like the European monetary union, is not a fiscal union. At the end of the day, it could introduce common liability through the back door'.[31]

While a community of loss sharing would greatly enhance the solidarity among NCBs in the euro area and diminish concerns about the survival of the euro area, it reduces the individual responsibility of national central banks and – in the context of NCB purchases of the Member States' sovereign bonds – the incentive of Member States to sound budgetary policy.

3. The constitutional law of risk sharing

This section examines the constitutional law of risk sharing in the euro area. The norms examined are constitutional in a formal sense, as they are part of EU primary law,[32] and also because they are a significant (though often overlooked) part of the EMU's macroeconomic constitution.[33] In light of the decentralized implementation of monetary policy in the Eurosystem, risk – in the form of potential profits as well as potential losses – is distributed through two channels. The first is the ECB itself, whose profits and losses are redistributed among its shareholders, the NCBs of the Eurosystem (Section 3.1). Whereas the Statute creates a clear mechanism for profit sharing amongst NCBs, loss sharing mechanisms amongst them are both more variable and subject to a greater degree of legal uncertainty and contestation (Section 3.2).

3.1. *The profits and losses of the ECB*

Typically, the profits of a central bank flow back to a state authority. But there is no such fiscal authority in the case of the euro area. Instead, euro area NCBs

31. Keynote speech by Jens Weidmann, 'Monetary and economic policies on both sides of the Atlantic' (Frankfurt am Main, 8 February 2018) <bis.org/review/r180208c.htm>.

32. Art 51 of the Treaty on European Union (TEU) specifies that Protocol (No 4) on the statute of the European System of Central Banks and of the European Central Bank has the same status as the Treaties.

33. See generally Kaarlo Tuori, *European Constitutionalism* (CUP 2015) 127 et seq.

are the shareholders of the ECB.[34] The Statute thereby provides a built-in mechanism for the sharing of profits and losses of the ECB with the euro area NCBs. (As a corollary, NCBs of Member States that are not a part of the euro area are excluded from the distribution of both profits and losses.)

In light of the decentralization of monetary policy implementation, the bulk of Eurosystem profits are earned by the NCBs. The ECB's limited profits derive in part from banknote issuance. Although banknotes are put into circulation by the NCBs, the ECB derives income from such issuance in accordance with a banknote allocation key that attributes 8% of seigniorage income to the bank.[35] It also derives income from certain securities purchase programmes such as the Securities Markets Programme[36] and its international swap lines.[37]

The distribution of profits is not automatic. The ECB has the possibility to build up reserves that can be used to offset potential losses at a future date. The Statute explicitly provides for the possibility to transfer an amount 'which may not exceed 20% of the net profit' to a general reserve fund that in turn may not exceed 100% of the ECB's capital. Since 2004, when the general reserve fund was used in full to offset a significant loss,[38] the ECB has made use of a general risk provision to which it can contribute without being limited by the 20% ceiling applicable for the general reserve fund.[39] The sum of the general reserve fund and the general risk provision should not exceed the total value of the paid-up capital by euro area NCBs.[40] Only the remainder of net profits after such transfers is to be 'distributed to the shareholders of the ECB in

34. Art 28.2 of the ESCB Statute provides that the NCBs are the holders of the ECB's capital, but only Eurosystem NCBs pay up their share of the subscribed capital (Art 48 of the ESCB Statute). The capital key, which is periodically revised, depends in part on the demographic weight of the Member State and in part on its GDP (ESCB Statute, Art 29).

35. Decision of the European Central Bank of 13 December 2010 on the issue of euro banknotes (recast) (ECB/2010/29) (2011/67/EU).

36. See Decision (EU) 2015/298 of the European Central Bank of 15 December 2014 on the interim distribution of the income of the European Central Bank (recast) (ECB/2014/57). For an overview of these purchase programmes, see Section 4.2 below.

37. Though, technically, both NCBs and the ECB have the power to create such swap lines, it is the ECB that has done so in practice. See ESCB Statute, Art 23 as well as ECB, 'Central bank liquidity lines' <ecb.europa.eu/mopo/international-market-operations/liquidity_lines/html/index.en.html>.

38. Langner, 'Article 33' (n 19) 1252-3.

39. Though Art 33 of the ESCB Statute makes no mention of this possibility, it is implied in Art 48.2 of the same document. Art 8 of Decision (EU) 2016/2247 of the European Central Bank of 3 November 2016 on the annual accounts of the European Central Bank (recast) (ECB /2016/35) provides that the Governing Council 'may establish a provision for foreign exchange rate, interest rate, credit and gold price risks… on the basis of a reasoned estimate of the ECB's risk exposures'. See also Langner (n 19) 1253.

40. Langner, 'Article 33' (n 19) 1255.

proportion to their paid-up shares'.[41] As a corollary, euro area NCBs will suffer a loss of earnings when the ECB does not make any net profit.

Eurosystem NCBs may also be affected when the ECB makes a loss.[42] When losses are fully offset by existing reserves, Eurosystem NCBs share in the ECB's losses merely through foregone earnings. When losses exceed its risk provision, the Governing Council may decide to offset losses against the monetary income of the NCBs (which would otherwise flow to the ECB in order to be redistributed to the NCBs in proportion to their capital key) during the relevant financial year.[43]

Yet it is possible for the ECB to run a loss that would exceed its risk provisions as well as the monetary income of euro area NCBs (if the ECB makes the decision to offset its losses against such income). The statute provides less clarity in such a scenario. As discussed above,[44] the literature tends to evoke the possibility of continued central bank operation with negative capital. This can become problematic when the practice affects the credibility of that bank or its ability to achieve its primary objective of price stability. In such a case, the recapitalization of the ECB might be desirable.[45] In light of the lack of a euro-wide fiscal authority, the Statute foresees the possibility of a capital increase to be provided by the NCBs.[46] Union legislation creates a ceiling for such capital increases; a ceiling that was reached in 2011 when the ECB decided to increase its capital in the aftermath of Global Financial Crisis.[47] With an absence of legislative reform, there is therefore currently no possibility to increase the ECB's capital. The ECB could also collect foreign reserve assets from national central banks[48] or increase the share of non-euro area ECBs in its paid-up capital.[49]

41. ESCB Statute, Art 33(1).

42. See generally Langner, 'Article 33' (n 19) 1246 et seq.

43. ESCB Statute, Art 33(2). See also Section 3.2 below.

44. Cf section 2.2 above.

45. Jens-Hinrich Binder, 'Drohende Zentralbankinsolvenz? Haftungs- und Verlustszenarien im Europäischen System der Zentralbanken vor dem Hintergrund der aktuellen Diskussion' (2018) 70 Juristenzeitung 328; Langner, 'Preliminary notes', (n 19) 1119.

46. ESCB Statute, Art 28.1, second sentence.

47. Council Regulation (EC) 1009/2000 of 8 May 2000 concerning capital increases of the European Central Bank [2000] OJ L115/1 limits such increases to EUR 5 billion. The ECB decided to increase its capital in light of 'the increase of the ECB's balance sheet total over the last years' in 2010. See Decision of the European Central Bank of 13 December 2010 on the increase of the European Central Bank's capital (ECB/2010/26) [2011] OJ L11/53.

48. ESCB Statute, Art 30.4. There is a ceiling of EUR 50 billion on such additional calls.

49. Currently, non-euro area Member States only pay up 3.75% of their subscribed capital. See Decision (EU) 2023/2816 of the European Central Bank of 7 December 2023 on the paying-up of the European Central Bank's capital by the non-euro area national central banks and repealing Decision (EU) 2020/136 (ECB/2020/2) (ECB/2023/36) [2023] OJ L2816/1.

The issue recently came to the public's attention when the ECB reported its first loss in two decades, as it was squeezed between rising expenses (driven by the rise in interest rates that it had initiated itself) and the significantly lower interest rates on the ECB's financial holdings. The loss exceeded its risk provision, and yet the ECB did not decide to offset its loss against the monetary income of the NCBs, in all likelihood because NCBs were confronted with similar difficulties. Instead, the ECB made the controversial decision to carry forward its losses in order to offset them against future profits. In accordance with its own accounting rules, the ECB registered the loss as a deferred asset.[50]

3.2. *The profits and losses of NCBs*

The rules on profits and losses of euro area NCBs are more complex. For one, euro area NCBs have a hybrid status as they are part of the Eurosystem, but they may also still undertake activities outside of that framework.[51] The profits and losses of NCBs derived from activities unrelated to the Eurosystem remain unaffected by the Statute's rules on profits and losses. In addition, the Statute created an asymmetry in the treatment of NCB profits and losses that does not exist for the ECB: whereas profits are typically shared among NCBs, losses, so the letter of the Statute suggests, are not.

In principle, profits made by NCBs within the framework of the Eurosystem are shared amongst euro area NCBs. The intention of the drafters of the Statute was to avoid competition within the Eurosystem for the profits derived from the execution of monetary policy operations.[52] It accordingly

50. ECB, 'Financial Statements of the ECB for the year 2023' (22 February 2024) <ecb.europa.eu/press/pr/date/2024/html/ecb.pr240222~2e8045adc3.en.html> 31. For a critique, see Buiter, 'Central Banks need to be Honest about their Losses' (*Project Syndicate*, 5 March 2024) <project-syndicate.org/commentary/ecb-fed-deferred-asset-fudge-to-mask-excessive-losses-by-willem-h-buiter-2024-03>. Whereas standard accounting rules would account for such losses on the liability side of the balance sheet, the ECB registers losses on the asset side of its balance sheet. As is common for central banks, the ECB indeed has the privilege to draw up its own accounting rules. In accordance with Art 26.2 of the ESCB Statute, the ECB draws up its annual accounts 'in accordance with the principles established by the Governing Council'. Those principles have been laid down in Decision (EU) 2016/2247 of the European Central Bank of 3 November 2016 on the annual accounts of the European Central Bank (recast) (ECB/2016/35). See also Freimuth, 'Article 26' in Siekmann (ed), (n 16) 1091, 1092; Binder (n 45) 332–333.

51. Art 14.4 of the ESCB Statute authorizes NCBs to 'perform functions other than those specified in this Statute'. Such functions are 'performed on the responsibility and liability of national central banks and shall not be regarded as being part of the functions of the ESCB'. See also section 5.4 below.

52. Langner, 'Article 32: Allocation of monetary income of national central banks' in Siekmann (ed) (n 16) 1211, 1219; Mayer (n 13) 263.

provides that 'the sum of the national central banks' monetary income shall be allocated to the national central banks in proportion to their paid up shares in the capital of the ECB…'[53] The resulting income is redistributed among the NCBs in the same proportion[54] if the ECB did not decide to offset its own loss against that of the Eurosystem NCBs.[55] Typically, such income flows back to the Member State in question.[56]

But if an NCB incurs losses as a result of Eurosystem monetary policy operations, who will foot the bill? The drafters of the Statute apparently did not believe the risk of losses of monetary policy operations to be significant.[57] Recent news of losses borne by NCBs prove nevertheless that the scenario is not merely hypothetical.[58] Article 32.4 of the Statute provides that:

> '[the] Governing Council may decide that national central banks shall be indemnified against costs incurred […in connection with the issue of banknotes or…] in exceptional circumstances for specific losses arising from monetary policy operations undertaken for the ESCB. Indemnification shall be in a form deemed appropriate in the judgment of the Governing Council; these amounts may be offset against the national central banks' monetary income'.

53. According to Art 32.5 of the ESCB Statute, 'The sum of the national central banks' monetary income shall be allocated to the national central banks in proportion to their paid-up shares in the capital of the ECB'. See also Hanspeter K Scheller, 'Art. 32 Verteilung der monetären Einkünfte der nationalen Zentralbanken' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje, *Europäisches Unionsrecht* (7th edn, Nomos 2015). Monetary income is the 'income accruing to the national central banks in the performance of the ESCB's monetary policy function' (Art 32.1 of the ESCB Statute). The rules according to which the income is calculated are laid down in Decision (EU) 2016/2248 of the European Central Bank of 3 November 2016 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (recast) (ECB/2016/36), as amended by Decision (EU) 202 0/1735 of the European Central Bank of 12 November 2020 amending Decision (EU) 2016/2 248 on the allocation of monetary income of the national central banks of Member States whose currency is the euro (ECB/2020/55).

54. ESCB Statute, Art 32.5.

55. ESCB Statute, Art 33.2.

56. For an overview, see Daniela Bunea, Polychronis Karakitsos, Niall Merriman and Werner Studener, 'Profit Distribution and Loss coverage rules for central banks' (2016) ECB Occasional Paper Series 169/2016, 10–13 <https://www.ecb.europa.eu/pub/pdf/scpops/ecbop169.en.pdf>.

57. Langner, 'Article 32' (n 52) 1227.

58. The Bundesbank narrowly escaped a loss by relying on its risk provisions, though it expects further losses in upcoming years that would likely exceed such provisions (see <bundesbank.de/en/press/press-releases/financial-buffers-enable-bundesbank-to-achieve-balanced-financial-result-925318>). In 2023, the Nederlandsche Bank could only partially cover its losses with its risk provisions and posted a net loss exceeding one billion (see <dnb.nl/en/general-news/dnbulletin-2024/dnb-records-negative-result-of-3-5-billion-in-2023/>).

The rule of the Statute sets a clear boundary as to what the Eurosystem can and cannot do,[59] thereby making a sharp contrast with the ECB's often discussed discretion.[60] In principle, euro area NCBs are responsible for their own losses, even when such losses are incurred as a consequence of monetary policy operations mandated by the ECB. Losses can only be shared in the presence of a Governing Council decision to that effect.[61] The discretion of the Governing Council is furthermore limited in that loss sharing is only possible if two conditions are fulfilled (neither of which is relevant in the context of losses incurred in relation to the issue of banknotes). The losses must be *specific*, which indicates that only certain monetary policy operations can be subject to loss sharing regimes, as opposed to all of them. It is unclear at what level of generality the condition should be understood. Does specificity require the Governing Council only to accept loss sharing, for example, for corporate securities issued by one specific issuer? Or could the Governing Council decide that *all* purchases in the context of one of its programmes – say, the Corporate Securities Programme or its Outright Monetary Transactions programme – are covered by the provision? Furthermore, the circumstances in which the losses emerge must be *exceptional*. Because central bank losses are relatively rare, the condition can arguably only apply to a subset of the losses incurred by NCBs. If central bank losses are believed always to be exceptional, specifying such a condition in the statute would be tautological. Admittedly, the vagueness of the Statute suggests that the Governing Council has considerable leeway in interpreting those conditions. Yet it is a general rule of interpretation that exceptions must be interpreted restrictively.[62] In any case, a literal interpretation of the Statute suggests that loss sharing can never be the default rule.

Yet the rule – at least as interpreted here – is at odds with Eurosystem practice. The ECB itself, through former President Draghi, pointed out that

59. Eg Clemens Fuest and Hans-Werner Sinn, 'Target Risks without Euro Exits' (2018) 19 CESifo Forum 4/2018, 37 ('self-liability (no risk sharing) is the rule under the Statute of the European System of Central Banks (ESCB) and of the ECB… Only in exceptional cases can NCBs hope to mutualize individual, well-defined losses if the Governing Council of the ECB explicitly decides to do so'). Contrary to the view of the GFCC, which maintains that the limits imposed by the Statute on the Governing Council are 'hardly specified in primary law'. GFCC, Order of 18 July 2017, 2 BvR 859/15, para 133.

60. Eg Joana Mendes, 'Law and discretion in monetary policy and in the banking union: complexity between high politics and administration' (2023) 60 CML Rev 1579.

61. Though the effect of the provision is typically taken to mean that other NCBs would indemnify the losses incurred by one of them, it has also been argued that the ECB could take over the losses of the NCB concerned. See David Baez Seara, 'Financial independence and its implications for euro area central banks' (2023) 30 MJ 506, 518.

62. Christoph Ohler, 'Rechtliche Mastäbe der Geldpolitik nach dem Gauweiler-Urteil des EuGH' (2015) 34 NVwZ 1001, 1006.

'[t]here is a combined ruling coming from the statutes of the ECB and from a Governing Council decision that a default mode is a full risk sharing mode'.[63] The ECB's view therefore appears to be not only that the Statute allows – if not mandates – full risk sharing among euro area NCBs, but also that this is currently mandated by Governing Council decisions. The claim is corroborated at least in part by ECB press releases,[64] internal ECB research papers,[65] annual reports of NCBs[66] as well as the literature.[67]

There is some irony to this evolution. Arguably, Article 32.4 makes it legally fairly straightforward to share NCB losses once they have occurred (if the ECB's Governing Council finds the political will to make such a decision). Once the losses have occurred, they are undoubtedly 'specific'. Arguably, most often it will be the case that the loss also occurred in 'exceptional circumstances'. In virtually all circumstances when losses occur, Article 32.4 will not stand in the way of a decision to share losses. But to adopt a norm *ex ante* according to which all losses will be shared, as a matter of general policy, does contradict the requirements of Article 32.4; losses at such a stage are not specific (as they haven't occurred yet), and the point of such a general policy is its general applicability to all circumstances, rather than the exceptional circumstances demanded by Article 32.4.

The Eurosystem practice to claim risk sharing to be a default rule is also controversial. The ECB's own General Counsel (writing in her personal capacity) points out that 'the sharing of the NCB losses is not imposed by the same Statute. There have been different rules adopted in this respect for the different monetary policy instruments and what they all have in common is

63. Mario Draghi, President of the ECB, 'Introductory statement to the press conference (with Q&A)' (Nicosia, 22 January 2015) <ecb.europa.eu/press/press_conference/monetary-policy-statement/2015/html/is150122.en.html>.

64. ECB, 'FAQ on purchases of corporate sector debt instruments under the Eurosystem's monetary policy purchase programmes' (13 February 2024) <ecb.europa.eu/mopo/implement/app/html/ecb.faq_cspp.en.html> ('In general, income and losses from decentralised monetary policy operations conducted by the Eurosystem are shared.')

65. Inmaculada Alvarez et al, 'The use of the Eurosystem's monetary policy instruments and operational framework since 2012' (2017) ECB Occasional Paper Series 188/2017, 55 <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op188.en.pdf> ('As a rule, income and losses from decentralized monetary policy operations conducted by the Eurosystem are shared').

66. Since 2009, the Bundesbank, for example, has regularly reported that 'Pursuant to Article 32.4 of the ESCB Statute, all risks from [lending to euro area credit institutions related to monetary policy operations denominated in euro], provided they materialize, are shared among the Eurosystem central banks in proportion to the prevailing ECB capital key shares'. See also Langner, 'Article 32' (n 52) 1228.

67. Marijn van der Sluis, 'National central banks in EMU: time for revision?' (2022) 23 JIBLR 19, 24-25. See also Langner, 'Article 32' (n 52) 1228.

that they express the calibration of the risk assessment for different standard and non-standard measures'.[68]

The literature is not of one mind on this issue. Some simply note the discrepancy between the text of the Statute and the apparent practice of the Eurosystem to share risks between the NCBs.[69] Those advocating greater solidarity among NCBs emphasize the Governing Council's margin of discretion,[70] or go so far as to argue that the principle of sincere cooperation requires full loss sharing.[71] At the opposite end of the spectrum, those advocating individual NCB responsibility respond that Article 32.4 rules out risk sharing for monetary policy operations implemented by all euro area NCBs,[72] or find a conflict with the no-bailout rule in the Treaties.[73]

Arguably, the lack of risk sharing reflects the anomaly of a monetary union constituted in the absence of a fiscal union. Yet it is commonly taken for granted that the Eurosystem operates as one entity, which tends to imply that losses would automatically be shared amongst euro area NCBs, signalling an evolution in public perception. Peter Praet, former Chief Economist at the ECB, notes for example that 'monetary policy in general implies risk-sharing'.[74] It is questionable, therefore, whether Article 32.4 is still adapted to the Eurosystem more than a quarter of a century after it was established.

4. Opacity as constitutional strategy

The Eurosystem's relative lack of transparency complicates the analysis of its loss sharing rules. Decisions relating to loss sharing practices are indeed not published by the ECB.[75] A request for access to documents by the author relating to decisions by which loss sharing rules under Article 32.4 of the

68. Chiara Zilioli, 'The ECB's Powers and Institutional Role in the Financial Crisis: A Confirmation from the Court of Justice of the European Union' (2016) 23 MJ 171, 176.

69. van der Sluis (n 67) 24–25. See also Langner, 'Article 32' (n 52) 1228.

70. Mayer (n 13) 304.

71. Martin Nettesheim, 'Die Europäische Zentralbank steht nicht über dem Recht' *Frankfurter Allgemeine Sonntagszeitung* (Frankfurt am Main, 25 January 2015) 6.

72. Ohler (n 62) 1006.

73. Binder (n 45) 334.

74. Mark Schrörs, Interview with Peter Praet, Member of the Executive Board of the ECB (11 December 2014) <ecb.europa.eu/press/inter/date/2014/html/sp141231.en.html>.

75. Although Union acts typically must be published in the Official Journal, the European Central Bank has a choice whether it publishes its decisions. Contrast Art 132(2) TFEU with Art 297 TFEU. See also Art 17.7 of the ECB's Rules of Procedure.

Statute were taken, was rejected and accepted in part by the ECB.[76] In response, the ECB published several historical decisions relating to loss sharing under monetary policy rules that are no longer in force, as well as two decisions relating to specific losses incurred by national central banks. Yet the current regulatory framework relating to loss sharing adopted in 2010 and 2014 was not made public, and neither was the loss sharing regime specific to the PSPP decision alluded to by Advocate General Wathelet in *Weiss*.

The publication of such norms was deemed incompatible with the public interest regarding the financial, monetary or economic policy of the Union or a Member State.[77] The Governing Council refuses to publish details relating to the current loss treatment framework because it 'could have a significantly adverse effect on the operational activities of the ESCB and could ultimately put at risk the smooth functioning and effectiveness of monetary policy'.[78] In order to protect its functional independence, the ECB deems it necessary to retain a margin of discretion, in particular when 'loss-treatment arrangements adopted in the past' might be subject to change.[79] In addition, publication 'would shift the public focus onto the national loss-implications of monetary policy decisions within the single currency area thus drawing undue attention on the impact at national level of the single monetary policy in the euro area' and could increase 'the pressure on NCBs to support specific loss treatment rules which minimize the income risks and/or maximize the expected income that, via the distribution of NCB profits, would largely flow to the government of the specific country'.[80] Finally, releasing such decisions could 'open it up to political scrutiny and might be liable to misinterpretation and negatively impact the public perception and understanding of the loss sharing mechanism'.[81] The ECB only released historical documents in so far as similar concerns no longer apply to those documents today, though they were not originally destined for publication to the public.

In doing so, the ECB perpetuates a problematic relationship of central banking with transparency.[82] The ECB and the NCBs sometimes communicate on applicable loss sharing rules with the public – at times, by means of press conferences or web publications – but it keeps tight control on

76. At least one request with similar content had previously been rejected by the ECB. Mayer (n 13) 313–315.

77. Decision of the European Central Bank of 4 March 2004 on public access to European Central Bank documents (ECB/2004/3) (2004/258/EC), [2004] OJ L80/42, Art 4.

78. ECB, 'Request for public access to non-public legal acts related to the sharing of losses arising from monetary policy operations' (27 February 2024, on file with the author).

79. ibid.

80. ibid.

81. ibid.

82. Stephen Millard, 'Central Bank Communication: Never excuse, never explain' (2022) NIESR Policy Paper 33. I am grateful to Carolyn Sissoko for pointing this out.

the information that circulates in the public sphere. It is apparent that the ECB is driven by a reluctance to expose the fragility of the euro area signified by these loss sharing arrangements. What follows is an attempt to reconstruct the loss sharing decisions of the Eurosystem.

5. Bickering over risk

How can Article 32.4 of the Statute, which enshrines a rule against loss sharing allowing only narrow exceptions, be reconciled with President Draghi's statement that full loss sharing among NCBs is the default mode of operation of the Eurosystem? In fact, the picture of risk sharing within the Eurosystem is a varied one. Its history and context shed light on the significance of President Draghi's statement. The analysis below examines how the Eurosystem distributes risk in the context of its ordinary (Section 5.1) and extraordinary (Section 5.2) monetary policy measures, as well as how risks can be moved to the balance sheets of the NCBs outside the reach of the Eurosystem (Section 5.4). It makes a short *excursus* to examine the credibility of Eurosystem policies under which losses are not shared (Section 5.3).

The Eurosystem uses two levers to control the distribution of risk: first, the decision on *who* will implement monetary policy decisions (the ECB, some or all euro area NCBs, or a combination of both). As described in section 3, this affects the applicable rules of profit and loss sharing. Second, the Governing Council has the ability to redistribute losses made by NCBs *ex post* in application of Article 32.4 of the Statute (decisions to redistribute are arguably subject to the difficulties analyzed in section 3.2). The legal uncertainty surrounding the norms of risk distribution thereby constitute the backdrop of significant distributive struggles within the Eurosystem. The EMU's peculiar institutional structure – one central bank confronting a multiplicity of national fiscal authorities – only accounts for part of this diversity in risk sharing practices.

5.1. *From punctual to generalized loss sharing*

At first sight, the practice of the ECB during the Global Financial Crisis appears to align with the Statute's decision that loss sharing between NCBs only occurs in 'exceptional circumstances' and for 'specific losses'. In 2008, several counterparties of the Luxembourg, German and Dutch NCBs defaulted. The Governing Council decided that 'losses arising from monetary policy operations undertaken by an NCB entitled to be indemnified on behalf of the Eurosystem in relation to a counterparty in default shall be borne by all

NCBs in proportion to the subscribed capital key and shall be shared…'[83] All NCBs created risk provisions accordingly. If a request for indemnification for the specific amount of realized losses is approved by the Governing Council, 'the other NCBs shall transfer their articles in respect of the realised losses to the NCB entitled to be indemnified via TARGET2 within the operational framework for the annual allocation of the monetary income of NCBs'.[84] After a run on the Dutch bank DSB Bank NV and the ensuing bankruptcy, the ECB decided to apply the same solution to all losses incurred by the Dutch NCB.[85]

Yet these loss sharing decisions are neither exceptional nor specific, as Article 32.4 of the Statute requires. In reality, both decisions invoke a pre-existing general framework providing for full loss sharing according to which 'losses arising from monetary policy operations undertaken by the Eurosystem are to be borne by all NCBs except where they arise as a result of the wilful or negligent act or omission of an NCB…'[86] Even before the formal introduction of the euro, the ECB had made the principled decision to share some of the losses that would emerge in the implementation of monetary policy by NCBs. This risk sharing framework originates in the ECB's collateral policy; a core element of the Eurosystem's monetary policy framework. The Eurosystem typically injects or withdraws liquidity in the European economy by means of reverse operations[87] with its counterparties. Should one of these counterparties default, the ECB can shield itself against losses by selling the collateral required in the framework of such reverse operations. The Statute indeed requires that lending be 'based on adequate collateral'.[88]

Decentralization is key to this story. Historically, it had proven a challenge. Although a single monetary policy was thought to require 'the implementation of such policy in a manner which is uniform throughout the

83. Decision of the European Central Bank of 18 December 2008 on the sharing of losses arising from monetary policy operations undertaken by certain national central banks for the Eurosystem (ECB/2008/NP23), Art 2 <ecb.europa.eu/ecb/access_to_documents/document/legal_act/shared/data/ecb.dr.leg_decision_ECB_2008_NP23_sharing_monetary_policy_losses20081218.en.pdf>.

84. Decision ECB/2008/NP23 (n 83), Art 5(2).

85. Decision of the European Central Bank of 18 January 2010 on the sharing of losses arising from monetary policy operations undertaken by De Nederlandsche Bank for the Eurosystem (ECB/2010/NP1), Art 2 <ecb.europa.eu/ecb/access_to_documents/document/legal_act/shared/data/ecb.dr.leg_decision_ECB_2010_NP01_sharing_monetary_policy_losses20100118.en.pdf>.

86. Decision ECB/2008/NP23 (n 83), Recital 2.

87. Reverse transactions are transactions 'whereby an NCB buys or sells eligible assets under a repurchase agreement or conducts credit operations in the form of collateralized loans…' See General Documentation Guideline (n 12), Art 10.

88. See ESC Statute, Art 18.1 and in the context of main refinancing operations General Documentation Guideline (n 12), Art 6.2(g).

participating Member States',[89] it was not easy to transcend the divergences in national practices regarding monetary policy implementation among the Eurosystem NCBs.[90] A compromise was found during the initial stages of implementation of euro area monetary policy: collateral could either fulfil 'uniform euro area-wide eligibility criteria specified by the ECB' ('tier one' collateral) or criteria 'established by the National Central Banks, subject to ECB approval' ('tier two').[91] NCBs were allowed to accept tier two collateral, but only at their own risk.[92] With regard to tier one collateral, however, the ECB decided as early as 1998 that 'such losses shall be borne by all NCBs, except where such losses arise as a result of the wilful or negligent action or inaction of an NCB, in which circumstances the losses shall be borne by the NCB in question'.[93] That decision was based on Article 32.4 of the Statute.

The 1998 Decision reverses the presumption of Article 32.4 of the Statute that losses are to be borne by NCBs individually with respect to monetary policy operations undertaken on the basis of tier one collateral. The reason to do so is straightforward: to the extent NCBs lost decisional control over their monetary policy operations with respect to such collateral, why should they carry the risks associated with such operations? The Decision to do so nevertheless appears at odds with the letter of the Statute, which provides that indemnification is only possible against 'costs incurred… in exceptional circumstances [and] for specific losses'. The decision addresses this tension in that it merely aims 'at establishing a set of principles on the basis of which the Governing Council may make decisions for specific losses arising in particular in relation to the use of eligible assets in the exceptional event of the default of a counterparty in ESCB liquidity providing operations'.[94] The solution is curious: although technically a specific decision is still required, in substance, its content is predetermined by a *de facto* loss sharing rule.

89. Guideline of the European Central Bank of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem (ECB/2000/7) [2000] OJ L310/1.

90. Jens van 't Klooster, 'The political economy of central bank risk management' (PhD thesis, University of Groningen 2021) 163.

91. Guideline on monetary policy instruments and procedures of the Eurosystem (n 89).

92. Decision of the European Central Bank of 22 December 1998 on the allocation of risks in relation to losses arising in ESCB credit operations (ECB/1998/NP29), Art 1(b) <ecb.europa.eu/ecb/access_to_documents/document/legal_act/shared/data/ecb.dr.leg_decision_ECB_1998_NP29_allocation_risks_losses19981222.en.pdf>.

93. Decision ECB/1998/NP29(n 92), Art 1(a). The rule was later confirmed by the Decision of the European Central Bank of 17 October 2003 on the allocation of risks in relation to losses arising in Eurosystem credit operations (ECB/2003/NP13) <ecb.europa.eu/ecb/access_to_documents/document/legal_act/shared/data/ecb.dr.leg_decision_ECB_2003_NP13_allocation_risks_losses20031017.en.pdf>.

94. Decision ECB/1998/NP29 (n 92), Recital 2.

Progressively, Eurosystem collateral policy was further harmonized during the initial years of Eurosystem operations. Starting in 2005, the ECB moved away from the two-tier system in favour of a single list of collateral to be accepted by all NCBs, on the basis of a common Eurosystem Credit Assessment Facility.[95] Accordingly, NCBs lost a degree of autonomy as collateral policy was now uniform across all euro area NCBs. Initially, this was seen as a move towards a unification of Eurosystem collateral policy.[96] Because of the disappearance of tier two collateral, the rule applying to tier one collateral would apply across the board, and therefore a full loss sharing regime emerged. It is perhaps in this context that the idea emerged that the Eurosystem's default rule is one of full loss sharing. The evolution makes the 1998 decision even harder to justify in light of Article 32.4 of the Statute: in the presence of a single list of collateral, the loss sharing regime now seems to cover *all* losses in the Eurosystem – making it harder to justify that the norm covers 'specific' losses in 'exceptional circumstances'. Subsequent policy statements indicate that this default loss sharing norm is still in force, though the decision of 1998 seems to have been superseded by multiple subsequent decisions on the sharing of losses arising from monetary policy operations.[97] One would suspect they contain a similar default loss sharing norm.

The unifying move would be disrupted only a few years later by the Global Financial Crisis and ensuing Eurocrisis.[98] These events prompted the ECB to broaden the range of collateral it would accept, increasing risks for the

95. The ECB announced that year that the 'Eurosystem is currently working towards introducing a single list of collateral eligible for Eurosystem credit operations…' ECB, Guideline of the European Central Bank of 3 February 2005 amending Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem (ECB/2005/2) [2005] OJ L111/1. The single framework for eligible assets is still applicable today. Cf Art 58 of the Guideline (EU) 2015/510 of the European Central Bank of 19 December 2014 on the implementation of the Eurosystem monetary policy framework (recast) (ECB/2014/60) [2015] OJ L91/3. See also Jens van 't Klooster, 'The ECB's Collateral Framework from the 1990s until the Pandemic' in Thomas Beukers, Diane Fromage and Giorgio Monti (eds) *The New European Central Bank* (OUP 2022) 87.

96. Löber, 'Die Neufassung der geldpolitischen Leitlinie der EZB und die Überarbeitung der Regelungen für notenbankfähige Sicherheiten' (2005) Zeitschrift für Bank- und Kapitalmarktrecht 353.

97. The ECB's response to the author's access to documents request refers (yet does not grant access) to the Decision of the European Central Bank of 25 November 2010 on the sharing of losses arising from monetary policy operations (ECB/2010/NP19) as well as to Decision of the European Central Bank of 9 July 2014 amending Decision ECB/2010/NP19 on the sharing of losses arising from monetary policy operations (ECB/2014/NP14) which, despite having been repealed, still contain provisions that were in force in February 2024 according to the ECB.

98. René Smits, 'A central bank in times of crisis: the ECB's developing role in the EU's currency union' in Peter Conti-Brown, Rosa Maria Lastra (eds), *Research Handbook on Central Banking* (Elgar 2018).

Eurosystem as a whole.[99] In addition to lowering harmonized European collateral standards, the ECB again allowed NCBs to 'accept as collateral for Eurosystem monetary policy operations credit claims that do not satisfy the Eurosystem eligibility criteria'.[100] The 'eligibility criteria and risk control measures' of these 'additional credit claims'[101] (hereafter ACC) are 'subject to prior approval by the Governing Council'.[102] The ACC framework has been described as 'essentially a return to the earlier two-tiered system'.[103] According to statements by the ECB as well as secondary literature, the risk is borne solely by the NCBs accepting such collateral.[104] The ACC framework would again be given a new lease on life as a policy tool throughout the coronavirus pandemic. NCBs were temporarily allowed to accept Greek debt as collateral, for instance.[105] Today, almost all euro area NCBs use national collateral lists.[106] Collateral policy, and risk sharing regimes, therefore remain fragmented to a significant degree.

5.2. *Quantitative easing*

The Global Financial Crisis, the Eurocrisis and the ensuing economic slump also prompted the ECB to experiment with its monetary policy toolkit. With interest rates effectively at zero, the Eurosystem decided to buy assets outright in the hope of staving off deflation. It has bought private sector assets, but it is

99. Hans-Werner Sinn, *The Euro Trap: On Bursting Bubbles, Budgets, and Beliefs* (OUP 2014) 153.

100. Art 4(1) and (2) of Decision ECB/2011/25 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral, later amended by Decision of the European Central Bank of 21 March 2012 amending Decision ECB/2011/25 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2012/4) [2011] OJ L341/65. See also Decision of the European Central Bank of 28 June 2012 amending Decision ECB/2011/25 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2012/11) [2012] OJ L17 5/17; Decision of the European Central Bank of 3 July 2012 amending Decision ECB/2011/25 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2012/12) [2012] OJ L186/38. See also Sinn (n 99) 163–164.

101. Guideline of the European Central Bank of 2 August 2012 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral, Art 4 and amending Guideline ECB/2007/9 (ECB/2012/18) [2012] OJ L218/20.

102. Additional credit claims decision ECB/2011/25 (n 100), Art 4(2).

103. van 't Klooster (n 95) 90.

104. ECB, Monthly Bulletin (February 2012) 28. See also Heidfeld (n 16) 951.

105. Guideline 2020/515 of the European Central Bank of 7 April 2020, Art 1, amending Guideline ECB/2014/31 on additional temporary measures relating to Eurosystem refinancing operations and eligibility of collateral (ECB/2020/21) [2020] OJ L110/26.

106. See ECB, 'Non-marketable assets' <ecb.europa.eu/mopo/coll/standards/nonmarketable/html/index.en.html#assessment>.

purchases of public sector debt that have been most controversial. The practice was extended during the COVID-19 pandemic.

Such balance sheet operations imply greater risks for the Eurosystem. In the context of its ordinary monetary policy measures, the Eurosystem incurs a loss when the counterparty defaults *and* the market price of the collateral decreases below the haircut applied at the time of transaction. When the Eurosystem buys outright, however, there is no counterparty. In the event of default or a decrease of the price of the asset below the haircut that was applied, the Eurosystem will incur a loss.[107] In other jurisdictions, such purchases are sometimes backed at least in part by Treasury expenses.[108] In the euro area, such fiscal backing remains implausible in the absence of a genuine supranational treasury.

5.2.1. *Private sector asset purchase programmes*

The division of labour – and, accordingly, the loss sharing rules – within the Eurosystem regarding purchases of private sector assets varies considerably. In one variation, purchases are made by all NCBs as well as by the ECB itself.[109] By contrast with ordinary monetary policy operations, the ECB has indeed often participated itself in these programmes. Typically, it has done so on the basis of the banknote allocation key, according to which the ECB would take up 8% of the purchases. That is the case for the covered bond purchase programmes in its different incarnations (CBPP, CBPP2 and CBPP3).[110] Another variation is that of selective decentralization, in which only specific euro area NCBs implement Eurosystem monetary policy. Under the corporate securities purchase programme (CSPP), 'specified Eurosystem central banks'

107. van 't Klooster (n 95) 90.

108. See eg in the US, the Term Asset-Backed Securities Loan Facility <federalreserve.gov/monetarypolicy/talf.htm> or in the UK, the Asset Purchase Facility Fund <bankofengland.co.uk/-/media/boe/files/asset-purchase-facility/2023/afp-annual-report-2023.pdf>.

109. The participation of the ECB is sometimes questioned in light of the principle of decentralization. See Heidfeld (n 16) 938.

110. Decision of the European Central Bank of 2 July 2009 on the implementation of the covered bond purchase programme (ECB/2009/16) [2009] OJ L175/18, Art 1; Decision of the European Central Bank of 3 November 2011 on the implementation of the second covered bond purchase programme (ECB/2011/17) [2011] OJ L297/70, Art 1; Decision of the European Central Bank of 15 October 2014 on the implementation of the third covered bond purchase programme (ECB/2014/40) [2014] OJ L335/22, Art 1; Decision (EU) 2020/187 of the European Central Bank of 3 February 2020 on the implementation of the third covered bond purchase programme (ECB/2020/8) (recast) OJ L39/6, Art 1. Recital 1 of the first programme suggests that the heading 'Eurosystem central banks' refers 'jointly' to euro area NCBs and to the ECB itself.

would purchase eligible securities.[111] The Governing Council's wish was for such purchases to be made 'in a decentralized manner', albeit on the basis of coordination with the ECB in order to safeguard the singleness of euro area monetary policy.[112] To do so, the Eurosystem relies on a 'specialisation scheme' that takes into account the issuer's country of the relevant securities.[113] The implementation of the asset-backed securities programme (ABSPP) relies on a different mechanism still.[114] The decision notes that the purchases were to 'be implemented in a uniform and, exceptionally during the initial phase, centralized manner…'[115] The Eurosystem relied on agents, i.e. external asset managers, to do so.[116] Later on, the decision envisioned that the ABSPP would 'be implemented in a uniform and decentralized manner by the Eurosystem central banks in accordance with a subsequent decision to that effect by the Governing Council…'[117] The programme has been implemented by six NCBs since 1 April 2017.[118]

It is to be expected that different loss sharing regimes would apply when different decentralization mechanisms operate. Loss sharing is automatically applicable whenever the ECB itself undertakes outright operations, or when other actors do so in the name of the ECB. It seems that the ABSPP programme is an example.[119] The situation is different when NCBs implement Eurosystem monetary policy. From a functional perspective, the case for loss sharing is the strongest in the context of selective decentralization, as only a few Eurosystem NCBs take on risks for the Eurosystem as a whole, whereas

111. Decision (EU) 2016/948 of the European Central Bank (CSPP Decision) of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16) [2016] OJ L157/28, Art 1.

112. ibid, Recital 9.

113. CSPP Decision (n 111), Art 5.

114. ECB press release, 'Eurosystem adjusts purchase process in ABS purchase programme (ABSPP)' (15 December 2016) <ecb.europa.eu/press/pr/date/2016/html/pr161215.en.html>; ECB, 'FAQ on the asset-backed securities purchase programme' (9 August 2023) <ecb.europa.eu/mopo/implement/app/html/ecb.faq_abspp.en.html>.

115. Decision (EU) 2015/5 of the European Central Bank of 19 November 2014 on the implementation of the asset-backed securities purchase programme (ECB/2014/45) [2015] OJ L1/4, Recital 3.

116. ECB, 'FAQ on the asset-backed securities purchase programme' (n 114).

117. ABSPP decision (n 115), Recital 4.

118. Bundesbank, *Annual Report 2016*, 51 <www.bundesbank.de/resource/blob/667854/cc3827288ada4404334b3d23fd156470/mL/2016-annual-report-data.pdf>. The Governing Council decision on the basis of which this transition occurred, appears not to have been made public.

119. De Nederlandsche Bank, *2020 Annual Report. Towards Recovery*, 62 <www.dnb.nl/media/djspazix/jaarverslag_2020_dnb_eng.pdf>. De Nederlandsche Bank indeed notes that the 'ABSPP *is on the ECB's balance sheet* and is primarily at the ECB's risk. Any losses in the ABSPP are ultimately reflected in a lower dividend pay-out from the ECB to the national central banks' (my emphasis).

profits from such operations will usually be shared.[120] Losses from the ECB's CSPP programme are indeed shared[121] (though legal objections about *ex ante* decisions remain in light of Article 32.4). That is not necessarily the case when purchases are distributed among all Eurosystem central banks. Purchases under the first and second covered bond purchase programmes were undertaken on the liability of the executing central bank,[122] whereas purchases under the third covered bond purchase programme are borne by all participating central banks in the Eurosystem.[123] The reason why is not immediately apparent. Finally, the private sector purchases under the pandemic emergency purchase programme are also fully risk shared.[124]

5.2.2. *Public sector asset purchase programmes*

A decade of economic crisis drove the Eurosystem, at different moments, to purchases of the public debt of its Member States and, at times, of supranational organizations. Such purchases are legally more convoluted, as the applicable legal constraints are more demanding.[125] Public sector purchases were initially driven by concerns over sovereign defaults threatening the euro area's stability. Later, the focus shifted to combating the threat of deflation.

Public sector purchases typically involve the ECB alongside the NCBs. The first such intervention by the ECB, the Securities Markets Programme (SMP), provided that the ECB and euro area NCBs would jointly purchase relevant instruments.[126] NCBs would conduct such purchases 'according to their percentage shares in the key for the subscription of the ECB's capital'.[127] The ECB's share in these purchases appears to amount to some 8% of eligible

120. Mayer (n 13) 304.

121. ECB, 'FAQ on purchases of corporate sector debt instruments under the Eurosystem's monetary policy purchase programmes' (13 February 2024) <ecb.europa.eu/mopo/implement/app/html/ecb.faq_cspp.en.html>; De Nederlandsche Bank, *2018 Annual Report*, 154 <www.dnb.nl/media/z4rdhnzf/2018-anual-report.pdf>.

122. Alvarez, 'The use of the Eurosystem's monetary policy instruments' (n 65) 55. See also Fuest and Sinn (n 59) 38; Mayer (n 13) 315.

123. Deutsche Bundesbank, *Annual Report 2021*, 61 <www.dnb.nl/media/djspazix/jaarverslag_2020_dnb_eng.pdf>.

124. ECB, 'FAQ on the pandemic emergency purchase programme' (19 June 2024) <ecb.europa.eu/mopo/implement/pepp/html/ecb.faq_pepp.en.html>.

125. Art 123 TFEU prohibits 'overdraft facilities or any other type of credit facility' to be granted to 'Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States', at least on primary markets. The provision was interpreted in Case C-62/14, *Gauweiler* and in Case C-493/17, *Weiss*, EU:C:2018:1000.

126. Decision of the European Central Bank (SMP Decision) of 14 May 2010 establishing a securities markets programme (ECB/2010/5) [2010] OJ L124/8, Recital 1 and Art 1.

127. SMP Decision (n 126), Recital 2.

securities.[128] Regarding Outright Monetary Transactions (OMT), the Bundesbank notes that purchases would be made in accordance with the Eurosystem's banknote allocation key: the ECB would assume 8% of purchases itself, whereas the NCBs would purchase the remainder in accordance with their capital key.[129] No information has been made public about the ECB's most recent programme, the Transmission Protection Instrument (TPI), which pursues a similar objective.

The Bundesbank reports that SMP risks would be shared in accordance with the euro area NCB capital key.[130] Despite the lack of transparency regarding the OMT decision, the ECB did later communicate publicly that losses would be shared if ever they came to occur. President Draghi affirmed that full risk sharing was an essential aspect of the OMT programme.[131] A member of the Executive Board confirmed that 'under an extreme scenario, with the default of the sovereign concerned, the resulting losses would have to be shared across the Eurosystem. Ultimately, this could indeed constitute a transfer of risk between euro area countries'.[132] Little is known about the risk sharing mechanism that would apply to the ECB's recent Transmission Protection Instrument. The similarities between TPI and its two precursors suggest that a full loss sharing mechanism would apply here as well, especially given that the programme was engineered in the aftermath of a scare on the Italian bond markets.[133] From a legal perspective, the same objections to an *ex ante* application of Article 32.4 as formulated in section 3.2 remain.

When public sector purchases were made to stave off deflation, with the launch of the Public Sector Purchase Programme (PSPP), the Eurosystem

128. The number likely derives from the banknote allocation key. Sinn nevertheless references 7% in Sinn (n 99) 263.

129. Bundesbank, 'Statement to the Federal Constitutional Court, with a particular focus on the OMT programme and the matter of TARGET2 balances' (21 December 2012) <bundesbank.de/en/homepage/statement-to-the-federal-constitutional-court-with-a-particular-focus-on-the-omt-programme-and-the-matter-of-target2-balances-799688> 26. The banknote allocation key derives from the ECB's Decision on the issue of euro banknotes (n 35), which has been amended several times since.

130. Deutsche Bundesbank, *Annual Report 2010*, 168 <www.bundesbank.de/resource/blob/665968/b155da70d1bcdc9871435e70541d93f2/mL/2010-annual-report-data.pdf>; see also Bundesbank, 'Statement to the Federal Constitutional Court' (n 129), with a particular focus on the OMT programme and the matter of TARGET2 balances (21 December 2012) 26. See also Heidfeld (n 16) 958; Klaus Tuori, 'Monetary Policy (Objectives and Instruments)' in Fabian Amtenbrink, Christoph Hermann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (OUP 2020) 656.

131. ECB (n 63).

132. Speech by Benoît Cœuré, Member of the Executive Board of the ECB, 'Outright Monetary Transactions, one year on' (conference entitled 'The ECB and its OMT programme', Berlin, 2 September 2013) <ecb.europa.eu/press/key/date/2013/html/sp130902.en.html>.

133. Mary McDougall and Martin Arnold, 'Italian bonds shrug off higher rates to eclipse other big debt markets' *Financial Times* (London, 13 April 2023) 8.

refined the division of labour within the Eurosystem. Initially, it specified that NCBs would purchase 92% of the total market value of purchases, whereas the remaining 8% would be done by the ECB[134] (the numbers were later revised to 90% and 10%, respectively).[135] PSPP furthermore foresaw a form of specialization with *ad hoc* deviations, in particular in so far as each NCB would purchase 'eligible securities of issuers of its own jurisdiction', i.e. the public debt of its own Member State.[136]

The PSPP decision provides that 12% of its purchases would be issued by international organizations and multilateral development banks and 88% by central governments and recognized agencies of the Member States. (The ratio would later be revised to 90% and 10%.[137]) Initially, it was only NCBs that purchased securities issued by international issuers. Later, the ECB began to purchase 12% (subsequently 10%) of the international securities.[138] The remaining international purchases are conducted on behalf of the Eurosystem by Banco de España and Banque de France.[139]

The PSPP decision, which aims to limit the risk of deflation in the euro area, put the question of loss sharing in the spotlight. An account of the debates within the Governing Council (a first in the ECB's history) reveals that the Governing Council considered a 'continuum of loss-sharing options' from full to no loss sharing, with a range of 'intermediary' solutions.[140] The Governing Council sought to strike a balance between the singleness of euro area monetary policy and the unique structure of the euro area, which lacks a supranational fiscal authority. The unpublished[141] loss sharing regime ultimately provides that purchases of the securities of European institutions (irrespective of who will buy them) and purchases of securities by the ECB are

134. Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10) [2015] OJ L121/20, Art 6(2).

135. ibid, Art 1(4) and Recital 5.

136. ibid, Art 6.3.

137. See Decision (EU) 2016/702 of the European Central Bank of 18 April 2016 amending Decision (EU) 2015/774 on a secondary markets public sector asset purchase programme (ECB/2016/8) [2016] OJ L121/24.

138. ibid.

139. See ECB, 'Implementation aspects of the public sector purchase programme (PSPP)' <ecb.europa.eu/mopo/implement/app/html/pspp.en.html>.

140. ECB, 'Account of the monetary policy meeting' of the Governing Council of the European Central Bank held in Frankfurt am Main on Wednesday and Thursday, 21–22 January 2015' <ecb.europa.eu/press/accounts/2015/html/mg150219.en.html>. Incidentally, it was the first time the ECB published an account of a governing council meeting.

141. AG Wathelet notes that loss sharing rules are laid down in an unpublished decision based on Article 32.4 of the ESCB Statute, further observing that 'possible losses would reduce the annual surplus that the ECB may pay to Eurosystem central banks or lead to losses being carried forward'. See Opinion of AG Wathelet in Case C-493/17, *Weiss*, para 90.

subject to loss sharing, for a total of 20% of purchases under the PSPP programme,[142] while other purchases are nevertheless made on the responsibility of NCBs. In particular, those NCBs will be responsible for purchases of the sovereign debt of their own Member State. The European Court of Justice (ECJ) did not analyze the legality of this loss sharing regime.[143]

The PEPP programme mimics the PSPP's distribution of labour within the Eurosystem,[144] though it innovated by providing that purchases would be 'conducted in a flexible manner allowing for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions'.[145] Under the PEPP, purchases of private sector securities are subject to loss sharing, while only 20% of public sector purchases are subject to loss sharing, as had been the case with the PSPP.[146]

5.3. *Excursus: the credibility of individual NCB responsibility*

Rules against loss sharing are justified on the basis of moral hazard concerns.[147] When NCBs have decisional leeway in the implementation of monetary policy decisions made by the Governing Council, but they are only exposed to a fraction of the risk attached to their decisions because of loss sharing rules, the incentives of those NCBs are misaligned. Take the example of an NCB who has discretion when it comes to the securities it chooses to buy outright as part of the ECB's Asset Purchase Programme. Because it only incurs part of the risk associated with that purchase, it may take excessive risks. Or take the example of an NCB that accepts collateral at its own risk as part of the additional credit claims framework, under the assumption that the losses of such an operation would not be shared. Because all NCBs are subject to the same disincentive, the Eurosystem as a whole would be taking on

142. ECB, 'ECB announces expanded asset purchase programme' (22 January 2015) <ecb.europa.eu/press/pr/date/2015/html/pr150122_1.en.html>.

143. Case C-493/17, *Weiss,* 159–167.

144. Art 5(1) of Decision (EU) 2020/440 of the European Central Bank of 24 March 2020 on a temporary pandemic emergency purchase programme (ECB/2020/17) [2020] OJ L91/1.

145. ibid, Art 5(2).

146. ECB, 'FAQ on the pandemic emergency purchase programme' (19 June 2024) <ecb.europa.eu/mopo/implement/pepp/html/ecb.faq_pepp.en.html>.

147. Moral hazard concerns were explicitly addressed by the Governing Council in the context of the PSPP decision, but they concern the moral hazard of sovereign borrowers, rather than of NCBs. ECB (n 140) ('…monetary policy action, particularly in the area of sovereign bond purchases, could not be seen in isolation from the actions of other policy actors. Possible moral hazard implications for euro area governments could weaken their incentives for structural reforms and fiscal consolidation.')

excessive risks. (The profit sharing mechanism nevertheless dilutes the potential gains for the NCBs.)

But it is doubtful whether this commitment not to share losses is credible. In the event that significant losses materialize, the credibility of the NCB in question may be endangered – and that would create a systemic problem for the Eurosystem as a whole. The capacity of the Eurosystem to effectively implement monetary policy in that Member State may be in doubt. When fiscal concerns prevent a Member State from recapitalizing the NCB, fears relating to 'the reversibility of the euro'[148] could emerge once more. In such circumstances, full risk sharing can 'counter perceptions of a lack of unity' and 'underline the singleness of monetary policy'.[149]

This creates a credibility problem for any commitment by the Eurosystem *not* to engage in loss sharing.[150] *Ex ante*, such a strategy might be a reasonable tool to attempt to dissuade NCBs from engaging in risky behaviour. But once losses have materialized and the effectiveness of euro area monetary policy, or even the survival of the euro area is called into question, that is unlikely to matter much. *Ex post*, if the losses are significant enough, the costs of an ineffective implementation or potential break-up of the euro area are likely to outweigh the moral hazard concerns that may prevail *ex ante*. The Eurosystem may then be unable to adhere to its own commitment. While *ex ante* commitments to loss sharing raise legal concerns, refusals to commit to loss sharing *ex ante* are thus arguably not credible from an economic perspective.

5.4. *Off the books lending*

But the Global Financial Crisis also drew attention to a very different strategy for tackling risk in the euro area: to simply take them off the balance sheet of the Eurosystem. As hybrid entities, NCBs may indeed undertake functions outside the framework of the Eurosystem.[151] That is always the case in lending of last resort – a 'key feature defining a "modern" central bank'[152] – in the framework of Emergency Liquidity Assistance (hereafter ELA). Though the

148. Mario Draghi, President of the ECB, Vítor Constâncio, Vice-President of the ECB, 'Introductory statement to the press conference (with Q&A)' (Frankfurt am Main, 6 September 2012) <ecb.europa.eu/press/press_conference/monetary-policy-statement/2012/html/is120906.en.html>.

149. ECB (n 140).

150. See also Izabella Kaminska, 'Eurozone: welcome to your currency board future' *Financial Times* (London, 31 March 2015) <www.ft.com/content/6563ae93-7196-3908-908d-4431d93f5935>.

151. Art 14.4 of the ESCB Statute authorizes NCBS to perform 'functions other than those specified in this Statute' but those functions 'shall be performed on the responsibility and liability' of those NCBs.

152. Ulrich Bindseil, *Central Banking before 1800. A Rehabilitation* (OUP 2019) 136.

architects of the euro area initially believed this function to be relatively unimportant because the granting of emergency liquidity had 'been a very rare event in industrial countries over the past few decades', the crisis called that assumption into question.[153] Yet the position of the ECB had always been that NCBs would remain lenders of last resort, and that any such action would be undertaken at their own risk.[154] Over the years, calls for the centralization of ELA policy at the ECB[155] have become more insistent, though no concrete steps have been taken in this direction yet. The repeated use of ELA during the financial crisis and ensuing Eurocrisis prompted the ECB to make its internal arrangements with NCBs more transparent in a series of communications on the subject.[156] They reaffirm that such actions are undertaken 'on the responsibility and liability of national central banks' rather than the Eurosystem.[157]

Depending on the volume of ELA operations, the NCBs' obligation to communicate the relevant details of the operation becomes more pressing. In the event that the volume of expected ELA operations exceeds EUR 500 million, NCBs must inform the NCB prior to granting ELA. If it exceeds EUR 2 billion, the Governing Council examines 'whether there is a risk that [it] may interfere with the objectives and tasks of the Eurosystem'.[158] The same communications emphasize the Governing Council's veto right. In practice, the ECB uses this power to allow the provision of ELA only when certain conditions have been fulfilled. Despite their critical economic and political significance, relevant ECB decisions are not published. For example, the ECB put a ceiling on the ELA, which the Bank of Greece was allowed to extend to

153. ECB, Monthly Bulletin (February 2007) 81.

154. ECB, *Annual Report 1999*, 98 <www.ecb.europa.eu/pub/pdf/annrep/ar1999en.pdf>. See also ECB, 'The EU Arrangements for Financial Crisis Management' in ECB Monthly Bulletin (February 2007) 73, 80–81.

155. Christos Gortsos, 'Last Resort Lending to Solvent Credit Institutions in the Euro Area Before and After the Establishment of the Single Supervisory Mechanism (SSM)' (European Central Bank (ECB) Legal Conference 2015) 53; Sara Elisa Dietz, 'The ECB as Lender of Last Resort in the Eurozone? An analysis of an optimal institutional design of Emergency Liquidity Assistance competence within the context of the Banking Union' (2019) 26 MJ 628. The point was already made in Smits (n 4) 269–271.

156. ECB, 'ELA Procedures (the procedures underlying the Governing Council's role pursuant to Article 14.4 of the Statute of the European System of Central Banks and of the European Central Bank with regard to the provision of ELA to individual credit institutions)' (17 October 2013) <ecb.europa.eu/pub/pdf/other/201402_elaprocedures.en.pdf>; ECB, 'Agreement on emergency liquidity assistance' (17 May 2017) <ecb.europa.eu/pub/pdf/other/Agreement_on_emergency_liquidity_assistance_20170517.en.pdf>; ECB, 'Agreement on emergency liquidity assistance' (9 November 2020) <ecb.europa.eu/pub/pdf/other/ecb.agreementemergencyliquidityassistance202012~ba7c45c170.en.pdf>.

157. ECB, 'ELA Procedures' (n 156).

158. ibid.

the Greek banking system[159] and authorized ELA to Cypriot banks only on the condition that a bailout programme would be concluded.[160] A most striking example is when the ECB requires NCBs to make use of ELA, as when Greek sovereign bonds no longer satisfied the Eurosystem's collateral requirements,[161] effectively shielding the Eurosystem from certain risks and transferring them to specific NCBs.

6. Lobbying for legal change

The Eurosystem's risk policies have also prompted quests to transform the applicable constitutional norms in a variety of directions: attempts to limit the degree of risk sharing that could be implemented on the one hand (Section 6.1) as well as attempts to protect NCBs should they incur losses so significant as to call into question their ability to operate (Section 6.2). Neither attempt has resulted in a constitutional transformation so far.

6.1. *Karlsruhe's sword of Damocles*

A constitutional sword of Damocles hangs over the Eurosystem's loss sharing policies in the form of the reaction of the German Federal Constitutional Court (GFCC) to the Eurosystem's partial loss sharing rules in the PSPP. The GFCC had raised a question to the ECJ as to whether it was compatible with the Treaties for the ECB 'to provide for the entirety of the losses that might be sustained by one of the central banks following a potential default by a Member State to be shared between the central banks of the Member States, in a context in which the scale of those losses would make it necessary to recapitalise that central bank'.[162] In light of the fuzziness of the primary law regarding risk sharing, the GFCC worried that 'the ECB Governing Council could modify the rules on risk sharing within the Eurosystem in a way that might result in risks for the profit and loss accounts of the national central banks and might also threaten the overall budgetary responsibility of national parliaments'.[163] In effect, it was assuming that the Eurosystem's commitment to limiting the sharing of losses among NCBs in the context of the PSPP decision was not credible.

159. Dietz (n 164) 641.
160. Clement Fontan, 'Frankfurt's double standard: the politics of the European Central Bank during the Eurozone crisis' (2018) 31 Cambridge Rev of International Affairs 162, 174-5.
161. ECB, 'Eligibility of Greek bonds used as collateral in Eurosystem monetary policy operations' (28 February 2012) <ecb.europa.eu/press/pr/date/2012/html/pr120228.en.html>.
162. Case C-493/17, *Weiss,* para 159.
163. GFCC, Order of the Second Senate of 18 July 2017 – 2 BvR 859/15, para 133.

Because it considered this question hypothetical, the ECJ did not provide an answer.[164] It merely observed that nothing indicated that losses would materialize. The PSPP decision does not provide for loss sharing in a form relevant to the GFCC's question, and primary law does not require it.[165] Thus, 'the ESCB has not adopted any rule allowing for the sharing of losses of a central bank of a Member State that derive from securities issued by issuers of that Member State. Nor has the adoption of such a rule been announced by the ESCB'.[166] The absence of loss sharing was nevertheless considered to be a factor in favour of the proportionality of the PSPP programme.[167]

While the GFCC acknowledges that its question was hypothetical in the eyes of the ECJ, it nevertheless interprets the latter's ruling as implying a veto for full risk sharing of the PSPP programme. In its view, its own question was hypothetical because the loss sharing scenario is 'legally impossible' in the context of 'the current European integration agenda (*Integrationsprogramm*)' as interpreted by the EU's highest court.[168]

In part, the GFCC relies on the fact that the PSPP programme consists of purchases of the public debt of the Member States. As the GFCC rightly underlines, such purchases are tightly regulated in order to 'ensure that the Member States remain subject to the logic of the market when they enter into debt'.[169] Relevant here are Article 123 TFEU on the prohibition of monetary financing of the Member States' and Union's public debt, as well as Article 125 TFEU, which bars the Union and its Member States from bailing each other out. The GFCC therefore concludes that risk sharing would violate 'the principle of national budget autonomy' and amount to 'direct monetary financing of state budgets' in violation of Article 123 as well as a form of financial assistance outlawed by Article 125 of the TFEU.[170] While the ECJ did not adhere to such a strict reading of the EU's macroeconomic constitution when similar questions were raised,[171] the GFCC takes advantage of the fact that the ECJ did not extend its line of argument to risk sharing within the

164. Case C-493/17, *Weiss,* paras 165–167. The AG agreed: Opinion of AG Wathelet in Case C-493/17, *Weiss*, paras 43–46.

165. Case C-493/17, *Weiss,* para 162.

166. Case C-493/17, *Weiss,* para 97.

167. Case C-493/17, *Weiss,* para 98. Although the interests that are being balanced here are not entirely clear, the GFCC believes they refer to the 'budgetary autonomy of the Member States'. See GFCC, Judgment of the Second Senate of 21 June 2016, 2 BvR 2728/13, para 132. See generally Marijn van der Sluis, 'Similar, Therefore Different: Judicial Review of Another Unconventional Monetary Policy in *Weiss* (C-493/17)' (2019) 46 LIEI 263, 276-9.

168. GFCC *Weiss* (n 163) para 224.

169. ibid, para 226.

170. ibid, para 226.

171. See generally Case C-370/12, *Pringle*, EU:C:2012:756, Case C-62/14, *Gauweiler* and Case C-493/17, *Weiss*.

Eurosystem. Its move endangers the Eurosystem's well-established loss sharing programmes when there is a risk of fragmentation in the euro area.[172] Yet, if this view relies in essence on the peculiar legal regime applicable to Eurosystem purchases of the Member States' public debt, the GFCC's conclusion would not be generalizable to forms of risk sharing not involving the public debt of the Member States.

But the GFCC's reasoning is more far-reaching in that it also addresses the legality of risk sharing *per se*, even when no purchases of public debt are involved. With little explanation, the court claims that the 'full risk sharing of possible losses' is 'manifestly incompatible with Art. 32.4 of the ESCB Statute'.[173] The GFCC's claim seems to go back to an interpretation (or misinterpretation) of the ECJ's statement that EU 'primary law includes no rules providing' for losses to be shared.[174] The GFCC interprets this statement to mean that 'full sharing of possible losses' is 'manifestly incompatible' with the Treaties because they 'do not confer the competences necessary [to that effect]… under EU law…' Adopting a full loss sharing rule would accordingly 'require a treaty amendment in accordance with Art. 48 TEU'. It even adds – contradicting the letter of Article 32.4 of the ESCB Statute – that 'such a rule could not be adopted through acts of secondary or tertiary law, including decisions by the ECB'.[175] As if that wasn't enough, any 'retroactive changes to the risk-sharing regime are prohibited', thereby ruling out 'any future acts of secondary or tertiary law creating such a loss-sharing regime…'[176] The court's reasoning nevertheless appears inconsistent: while it insists that loss sharing is 'manifestly incompatible with Article 32.4' of the Statute, it also recognizes that loss sharing violates national budget autonomy 'with the exception of the indemnifications provided for in Article 32.4 of the ESCB Statute',[177] suggesting that Article 32.4 of the Statute may be used in order to share losses.

While this second perspective appears difficult (if not impossible) to square with Article 32.4 of the ESCB Statute and the ECJ's judgment in *Weiss*, in particular when no purchases of public debt are involved, it contributes to the already considerable amount of legal uncertainty surrounding the sharing of losses between euro area NCBs. The threat of a Karlsruhe veto over euro area loss sharing arrangements is therefore real, although the threat has not had any significant consequences so far.

172. The SMP, OMT and (presumably) TPI programmes. Cf Section 5.2.2 above.
173. GFCC *Weiss* (n 163) para 226.
174. Case C-493/17, *Weiss,* para 162.
175. GFCC *Weiss* (n 163) para 224.
176. ibid, para 224.
177. ibid, para 226.

6.2. *A legal obligation to recapitalize central banks*

The risks associated with a lack of loss sharing also prompt a very different response, in the form of attempts to create an affirmative legal duty for Member States to recapitalize central banks when a scenario of policy insolvency looms. Though the opinions of NCBs diverge on the appropriateness of such recapitalizations,[178] a legal obligation of that nature may well exist. Only two Member States currently provide for such an obligation under national law. The budget of the Republic of Slovenia must cover the losses of the Slovenian central bank that cannot be covered by its general reserves.[179] The German Bundesbank is protected by the case law of the GFCC, which reads the Basic Law to imply 'a rule on institutional liability requiring the guarantor, the Federal Republic of Germany, to guarantee the functioning of the German Bundesbank…' Should the net equity of the Bundesbank reach a point that threatens its ability to operate, Germany 'may' be required to inject additional capital.[180] But most national laws do not require recapitalization.[181]

Yet such an obligation could derive from EU law. The ECB has consistently lobbied for this view, arguing in favour of a financial dimension to the principle of central bank independence (hereafter 'CBI').[182] NCBs should 'be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled'.[183] In essence, financial independence requires 'that an NCB should always be sufficiently

178. The Bundesbank concurs that 'additional transfers [from the German government] could become necessary if a large loss were to be carried forward over several years'. See generally Bundesbank, 'Statement to the Federal Constitutional Court, with a particular focus on the OMT programme and the matter of TARGET2 balances' (21 December 2021) <www.bundesbank.de/resource/blob/799688/a6e46b9d71e86f076c2aa07e1cd24b7a/mL/2012-12-21-omt-data.pdf> 27. The Czech National Bank argues that recapitalization is not needed as it can carry forward potential losses. See Seara (n 61) 510 with reference to Marek Petrus, CNB press release 'The Czech National Central Bank disagrees with the ECB Convergence Report' (12 May 2010) <cnb.cz/en/cnb-news/press-releases/The-Czech-National-Bank-disagrees-with-the-ECB-Convergence-Report-00001>.

179. Bank of Slovenia Act, Art 51 ZBS-1 Official Gazette of the Republic of Slovenia [Uradni list RS] 58/02 of 4 July 2002.

180. GFCC *Weiss* (n 163) paras 216-7. It derives the rule from Art 88 of the Basic Law, which reads 'The Federation shall establish a note-issuing and currency bank as the Federal Bank'.

181. Mayer (n 13) 294, 331-2.

182. See generally Langner, 'ESCB/Eurosystem/National Central Banks' in Amtenbrink, Hermann, Repasi (eds) (n 130) 389, 421-22.

183. European Monetary Institute, 'Progress Towards Convergence 1996' (1996) <www.ecb.europa.eu/pub/pdf/conrep/cr1996en.pdf > 102-3.

capitalised'.[184] Should 'an NCB's net equity [become] less than its statutory capital or even negative', its Member State would have to 'provide the NCB with an appropriate amount of capital at least up to the level of the statutory capital within a reasonable period of time…'[185] Since the first convergence report of the European Monetary Institute in 1996, the ECB has pointed out that even 'if an NCB is fully independent from an institutional and functional point of view, but at the same time unable to avail itself autonomously of the appropriate economic means to fulfil its mandate, its overall independence would nevertheless be undermined'. The ECB has criticized national frameworks accordingly[186] and has insisted on financial independence in its convergence reports[187] as well as in a series of opinions on a variety of legal matters.[188]

Despite the pleas of one of its Advocates General, the ECJ has been less eager to recognize a financial dimension of CBI. In *Banka Slovenije*, Advocate General Kokott echoed the ECB's view that a link exists 'between a central bank's weak equity situation and its ability to pursue the objective of maintaining price stability effectively and in complete independence'.[189] If a central bank were forced to operate with 'very low or negative capital for a prolonged period of time, it may be incentivized to use monetary policy operations for the purpose of generating revenue to counter the perception of instability and to maintain market confidence', with potentially inflationary effects.[190] Yet for the ECJ, the central question was the possibility of political pressure on the central bank, as opposed to its balance sheet. The financial fragility of a central bank is problematic only to the extent that it 'is liable to

184. ECB, 'Convergence Report, June 2022', 26 <ww.ecb.europa.eu/press/other-publications/convergence/html/ecb.cr202206~e0fe4e1874.en.html>.

185. ibid. The ECB also likes to point out that, as shareholders of the ECB, the NCBs may also be called upon to contribute to a capital increase of the ECB. Yet the NCBs can straightforwardly recapitalize the ECB by money creation. See Opinion of AG Kokott in *Weiss* (n 164) para 61.

186. ECB, 'Convergence Report, March 1998', 295. <www.ecb.europa.eu/pub/pdf/conrep/cr1998en.pdf> The same report criticizes the legal framework of national central banks with respect to their financial independence.

187. The ECB has consistently referred to the principle of financial independence in its convergence reports up to the present day.

188. Eg Opinion of the European Central Bank of 16 July 2014 on the competence for coin issuance (CON/2014/56); Opinion of the European Central Bank of 28 May 2019 on judicial relief granted to former holders of qualified bank credit (CON/2019/20); Opinion of the European Central Bank of 20 April 2020 on reform of Sveriges Riksbank (CON/2020/13).

189. Opinion of AG Kokott in Case C-45/21, *Banka Slovenije*, EU:C:2022:241, para 76. See also Marijn van der Sluis, 'National Central Banks as branches of the ECB? The Opinion of AG Kokott in *Banka Slovenije*', (EU Law Live, 11 April 2022) <eulawlive.com/the-opinion-of-ag-kokott-in-banka-slovenije-c-45-21-by-marijn-van-der-sluis/>.

190. ibid, para 78.

place that central bank in a situation of dependence on the political authorities of the Member State to which it belongs',[191] in particular when it would be 'potentially exposed to political pressure' as it might 'be forced to seek the consent of those political authorities in order to obtain funding or recapitalisation'.[192]

This difference in emphasis matters because of the view that a central bank can operate with low or even negative capital.[193] Whereas the ECJ's restrictive interpretation of CBI suggests that this is unproblematic as long as there is no risk of political abuse, the view of its Advocate General suggests, to the contrary, that a weak central bank balance sheet is in itself problematic for CBI. The ECB's attempts to create a legal obligation for the Member States to recapitalize its NCB when its net equity is too low have therefore so far fallen on relatively deaf ears in Luxembourg.

7. Conclusion

The asymmetry of the EU's Economic and Monetary Union has significant consequences for both fiscal and monetary policy. Indeed, the Eurosystem often operates in a decentralized fashion, relying on NCBs to implement monetary policy decisions. This raises an architectural question for the Eurosystem: should the losses incurred by NCBs be shared by all Eurosystem NCBs or not? A Eurosystem without loss sharing is precarious in that it multiplies the number of single points of failure. Even if the Eurosystem as a whole is in good financial health, a weakness in a single NCB endangers the credibility of monetary policy in the jurisdiction of that NCB. When the Member State concerned is unwilling or unable to recapitalize the NCB in question, concerns about the survival of the euro area as a whole may resurface. The decentralized institutional design of the Eurosystem is then also a source of its own fragility.

If the Eurosystem is a community of loss sharing, however, decentralization might not matter much. Because losses are shared proportionately, losses have to have a greater order of magnitude in order to have a meaningful impact on the balance sheets of the NCBs than when they are not. Even if losses are so significant as to require recapitalization by Member States, spreading out the costs reduces the risk of sovereign insolvency.

191. Case C-45/21, *Banka Slovenije*, EU:C:2022:670, para 101. See also Thibault Martinelli, 'The liability of national central banks acting as resolution authorities, financial independence, and the prohibition of monetary financing: *Banka Slovenije*' (2023) 60 CML Rev 1721.

192. Case C-45/21, *Banka Slovenije*, paras 104 and 102.

193. See text accompanying n 19–25.

The Union's constitutional framework and the Eurosystem's current and past policies formulate an answer to this architectural question, albeit their answer is paradoxically different. Article 32.4 of the ESCB Statute establishes a clear constitutional norm: while the Statute decided to redistribute the profits of the NCBs incurred in the context of their Eurosystem operations, it made the decision not to socialize the losses of the NCBs incurred in the context of monetary policy operations, except in 'exceptional circumstances' and for 'specific losses'. Yet in its communications to the public, the Eurosystem emphasizes that its default mode of operation is always one of full risk sharing between NCBs. Previously unpublished decisions by the ECB confirm that a decision in this sense was made at the very start of operations in the euro area. A central pillar of Eurosystem risk management is therefore arguably at odds with both the letter and spirit of the Statute.

Beyond ordinary monetary policy measures, a diverse landscape of loss sharing strategies comes into view, suggesting a distributive struggle among NCBs in the euro area over the question of loss sharing. Monetary policy operations relying on collateral accepted by NCBs – not by the Eurosystem as a whole – are implemented at the risk of the NCB in question. The Eurosystem's asset purchase programmes adopted in the context of economic crisis likewise vary widely. Some are implemented by the ECB itself, creating an indirect form of risk sharing. Other monetary policy decisions are implemented by selected euro area NCBs, with full risk sharing among all NCBs. Other programmes still are implemented by all NCBs, at times with full loss sharing and at times without any loss sharing. Famously, the public sector purchase programme operates without loss sharing when euro area NCBs buy the public debt issued by their own Member States. Yet similar public debt purchase programmes adopted amid fears of a euro area break-up do operate with full loss sharing among all NCBs.

Several policy arguments are at play. On the one hand, moral hazard concerns suggest NCBs should bear the costs for the risk assessments they make themselves. On the other, once significant losses do materialize on the balance sheets of NCBs, fears about the reversibility of the euro might emerge. This creates a credibility concern for the Eurosystem. Whereas emphasizing moral hazard concerns is optimal *ex ante* in order to prevent excessive risk taking by central banks, loss sharing becomes optimal *ex post* once fears of a eurozone breakup emerge.

While policy actors are struggling over the distributive implications of risk and loss sharing in the euro area, they are simultaneously seeking to transform the regulatory landscape applicable to them. This is most obvious in the ECB's (arguably problematic) early attempt back in 1998 to transform Article 32.4 of the Statute – which enshrines a principle against loss sharing, subject to exceptions – into a default loss sharing rule, similarly subject to exceptions. This casts a shadow of legal doubt over the legal foundations of risk sharing in the euro area: is such a default loss sharing rule compatible with primary law? Is it permissible, for example, in light of Article 32.4 of the Statute, for the Governing Council to decide *ex ante* that controversial bond buying schemes such as OMT would be subject to full loss sharing? This article argues that this is not permissible. The ECB has furthermore been advocating a norm of functional independence in order to create an obligation for euro area sovereigns to recapitalize their central banks when they do not dispose of sufficient economic means to fulfil their mandate. Simultaneously, the GFCC seeks to make a (very problematic) argument that risk sharing is incompatible with the Treaties.

The constitutional framework of euro area risk sharing is arguably outdated. The resilience of the Eurosystem derives in no small part from its capacity to act as one. As the ECB's former Chief Economist Praet underlined,[194] monetary policymaking implies a form of risk sharing. To strengthen the credibility of the Eurosystem, an amendment to the Statute appears warranted – if not to require loss sharing across the board, then at least to confirm the legality of a default loss sharing rule beyond the currently narrowly prescribed conditions of Article 32.4 of the Statute.

194. Cf text accompanying n 74.