INTERNATIONAL LAW ASSOCIATION

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INTERNATIONAL MONETARY LAW

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General introduction

Since the last ILA conference in Lisbon in 2022, the Committee on International Monetary Law, commonly known by its acronym MOCOMILA, has held three meetings: in London, United Kingdom (1-2 December 2022), Paris, France (16-17 June 2023) and Tokyo, Japan (30 November-1 December 2023). These meetings covered both topical issues, such as digital currencies and economic sanctions, and more classic issues, such as central bank accountability and the judicial review of banking supervision. They have also covered a wide range of areas of economic law, including central banking, prudential supervision, and financial regulation.

The London meeting took place at the Bank of England and was co-organised by Sonya Branch and Professor Rosa Lastra. The general theme of the meeting was "Central Bank Mandates in an Evolving World" and the discussion focused on topics such as crypto assets, the central bank mandate on climate change, and central bank accountability. In this meeting, Mr Jonathan Fried, on behalf of the MOCOMILA Membership Committee, presented the Committee's report, including the guiding principles for updating the membership.

Our Paris conference was hosted by the Bank of France and co-organised by Georges Affaki, Christophe Arnaud, Régis Bismuth and Edouard Fernandez-Bollo. The meeting coincided with the 150th anniversary of the ILA. It focused on issues related to the review of banking supervisory decisions and legislative initiatives to address banking crises in Europe. The meeting included presentations by Karl-Philipp Wojcik, General Counsel, Single Resolution Board, and Denis Beau, First Deputy Governor of the Banque de France.

The Tokyo meeting was hosted by the Bank of Japan and organised by Professor Hideki Kanda. The meeting focused on the latest developments in digital currencies as well as finance, monetary policy and the environment. A separate panel was dedicated to contemporary challenges in international economic law, including security, and the digitalisation of trade and trade finance. The Governor of the Bank of Japan, Mr Kazuo Ueda, addressed the Committee with a dinner speech.

MOCOMILA is proud to announce the publication of two books resulting from its discussions and with contributions from its members. The first book "International Monetary and Banking Law in the post COVID-19 World", edited by William Blair, Christos Gortsos and Chiara Zilioli, has been published by Oxford University Press in 2023. The second book "International Sanctions - Perspectives on Monetary and Financial Law", edited by Chiara Zilioli, Régis Bismuth and Luc Thévenoz, will be published by Brill at the end of 2024.

The subjects of the discussions of the Committee are reflected in the following sections of this report.

I. The Climate Emergency and the Financial Sector (text supporting MOCOMILA proposal for an ILA Resolution)
II. Climate change and central banks (by Professor René Smits)
III. CBDCs and Cryptocurrencies (by Mr Diego Devos)
IV. Central Banks: Communication and Accountability (by Professor Rosa Lastra)
V. Economic Sanctions (by Professor Régis Bismuth)
VI. Judicial Review of Banking Supervision (by Professor Michael Waibel)
VII. Developments in International and EU Banking Regulation during 2022-2023 (by Professor Christos V. Gortsos)

This report reflects the views of the individual members and not necessarily those of any institutions with which they are affiliated. The report has been endorsed by the whole Committee.

I. The Climate Emergency and the Financial Sector

A. Introduction

The climate emergency, together with the unprecedented decline in nature, poses an existential threat to humanity. The 2023 Report of the United Nations' International Panel on Climate Change (IPCC) has emphasised that there is a rapidly closing window of opportunity to secure a liveable and sustainable future for all, and that the choices and actions implemented in this decade will have impacts now and for thousands of years.[1]

The climate emergency is directly relevant to the financial sector, and to the work of central banks and supervisors. Further efforts are needed to address barriers to redirecting capital towards climate action,[2] and to address the risks the climate emergency poses to price stability, financial stability and the soundness of financial institutions[3].

Likewise, the decline in nature can have a direct impact on the financial sector. Nature-related risks, including those associated with biodiversity loss, could have significant macroeconomic implications; and failure to account for, mitigate, and adapt to these implications is a source of risks for financial institutions, as well as for financial stability.[4]

Part I of this report highlights the key legal considerations in respect of the climate emergency and decline in nature, and the financial sector. It demonstrates the need for international institutions, governments, central banks, supervisors, institutions in the financial industry, and the international legal community to do more to support and enable action, within their respective mandates and fields of influence. Such obligations do not just derive from a moral imperative, but from the rule of law: this includes both legally binding international climate commitments, and fundamental human rights, which are increasingly recognised as justiciable before the courts.

B. International climate and nature commitments

In order to address this existential threat to humanity, 196 States have committed themselves in a binding manner under international law, as signatories to the Paris Agreement.[5] The Paris Agreement establishes a climate mitigation goal of keeping global average temperature increases to well below 2°C above pre-industrial levels, and preferably to 1.5°C. The Paris Agreement aims, *inter alia*, to make finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. It also requires its parties to submit, and periodically update, national climate mitigation targets ("Nationally Determined Contributions"). Nationally Determined Contributions are expected to reflect a party's "highest possible ambition". The Paris Agreement was adopted by 196 parties at COP 21 in Paris, on 12 December 2015, and entered into force on 4 November 2016.

These international commitments have been transposed into national, regional and supranational laws. For example, the EU has transposed the objectives of the Paris Agreement into a binding and directly applicable EU Regulation – the European Climate Law.[6] The European Climate Law sets the

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[1] IPCC (2023), Sections. In: Climate Change 2023: Synthesis Report. Contribution of Working Groups I, II and III to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change, IPCC, Geneva, Switzerland, pp. 35-115.

[2] IPCC (2023).

[3] NGFS (2019), A call for action Climate change as a source of financial risk, April 2019.

[4] NGFS (2022), Statement on Nature-Related Financial Risks, March 2022.

[5] The 2015 United Nations Climate Change Conference (COP 21) was the 21st yearly session of the Conference of the Parties (COP) to the 1992 United Nations Framework Convention on Climate Change (UNFCCC).

[6] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law'), OJ L 243, 9.7.2021, p. 1.

overall framework for the EU's contribution to the Paris Agreement, which comprises substantive targets and procedural mechanisms. It sets legally binding targets of reducing GHG emissions by at least 55% compared to 1990 levels by 2030, and of net zero GHG emissions by 2050. It requires relevant EU institutions and the Member States to take the necessary measures to achieve the climate-neutrality objective.

However, the 2023 Report of the United Nations' International Panel on Climate Change (IPCC) has noted that current mitigation and adaptation actions and policies are not sufficient. The Report found that there are gaps between global ambitions and the sum of declared national ambitions. These are further compounded by gaps between declared national ambitions and current implementation for all aspects of climate action. These conclusions were noted with alarm and serious concern by the Parties at COP28 in Dubai on 13 December 2023, in the context of the outcome of the first global stocktake.[7]

C. Climate and nature finance: the need for public and private investment

The Paris Agreement and the Kunming-Montréal Global Biodiversity Framework explicitly highlight the crucial the role of finance in addressing the climate and nature crises. The Paris Agreement emphasise the need to make finance flows consistent with the pathway towards low greenhouse gas emissions and climate-resilient development[8] and both frameworks emphasise the importance of public and private investment.[9]

However, the 2023 IPCC Report has found that insufficient financing, and a lack of political frameworks and incentives for finance, are key causes of the implementation gaps for both mitigation and adaptation.[10] Finance, technology and international cooperation are critical enablers for accelerated climate action. If climate goals are to be achieved, both adaptation and mitigation financing would need to increase many-fold. The Report noted that there are barriers to redirecting capital towards climate action both within and outside the global financial sector. These barriers include the inadequate assessment of climate-related risks and investment opportunities.

These findings were noted in the outcome of the first global stocktake at COP28 in Dubai, emphasising that both adaptation and mitigation financing would need to increase manyfold. The outcome noted that there is sufficient global capital to close the global investment gap but there are barriers to redirecting capital to climate action, and that governments through public funding and clear signals to investors are key in reducing these barriers and investors, central banks and financial regulators can also play their part. [11]

D. Climate and environment-related litigation

Systemic climate litigation is also driving the development of clear and actionable legal obligations on States, companies and financial institutions to take climate action. A growing number of national court judgments are identifying and enforcing obligations on States to take action based not only on their international climate commitments, but also on fundamental rights – most notably the right to life and the right to private and family life[12]. In the landmark 2019 case of *Urgenda Foundation v the*

[7] UNFCC, Matters relating to the global stocktake under the Paris Agreement, Decision CMA.5, 13 December 2023.
[8] Article 2 Paris Agreement.
[9] Article 9 Paris Agreement; Target 19 Kunming-Montréal Global Biodiversity Framework.
[10] See Section 2 (Finance) from the outcome of COP28 (UNFCC, Matters relating to the global stocktake under the Paris Agreement, Decision CMA.5, 13 December 2023).
[11] See point 16(e), UNFCC, Matters relating to the global stocktake under the Paris Agreement, Decision CMA.5, 13 December 2023.
[12] UN Environment Programme (2023), *Global Climate Litigation Report: 2023 Status Review*, July 2023; Setzer, J. and Higham, C. (2023), *Global trends in climate change litigation: 2023 snapshot*, Grantham Research Institute on Climate Change and the Environment, June 2023; NGFS (2023a), *Report on climate-related litigation*, September 2023.

Netherlands, the Dutch Supreme Court, relying inter alia on the European Convention on Human Rights, found that the Dutch State was under an obligation to reduce Greenhouse Gas (GHG) emissions. The Court held that the obligation to take suitable measures to protect fundamental rights applies to environmental hazards – specifically the climate crisis – that threaten large groups or the population as a whole, even if the hazards will only materialise over the long term. It ordered the Dutch State to reduce GHG emissions by at least 25% by the end of 2020 compared to 1990. The *Urgenda* case has led to further successful litigation in other States, most notably Belgium, France, Germany and Ireland, with similar claims currently before the courts in Austria, the Czech Republic, Italy, Poland and Spain. In its recent landmark judgment in Verein Klimaseniorinnen v. Switzerland, the Grand Chamber of the ECHR established that climate change is 'one of the most pressing issues of our times' and that States have a positive obligation to adopt measures to mitigate climate change under Article 8 ECHR, the right to family and private life.

Following the success of cases against States, litigation against companies and financial institutions is a rapidly growing trend, with implications for the financial sector.[13] Litigation against companies has expanded beyond cases against fossil fuel and energy companies, to address car manufacturers, airlines, food companies and producers of concrete and plastics. A wide variety of legal arguments are being used as the basis for such claims, including claims under tort law, claims for breaches of corporate due diligence laws and for greenwashing and claims against directors for alleged breaches of fiduciary duties to adapt the company to the climate transition. The emerging trend of litigation against financial institutions has likewise relied on corporate due diligence laws, consumer and investor protection laws, and fiduciary duties.

The trend in climate and environment-related litigation is relevant to the financial sector for two key reasons. First, it demonstrates the justiciability of climate justice, and the risk of challenge for failure to take climate action – be that action by states, companies, or financial institutions. Second, it is a source of risk to individual institutions and the financial sector, which needs to be addressed by supervisors.[14]

E. Impact on price stability, financial stability, and the soundness of individual financial institutions

The climate emergency and decline in nature[15] pose risks to price stability, financial stability, and the soundness of financial institutions, which must be addressed by central banks and prudential supervisory authorities, within their mandates. While governments are the primary actors when it comes to setting and implementing climate policies, given the scale of the threat, monetary policy and supervisory action must play an important contributory role. However, monetary policy and supervisory action alone will not effectively compensate for failures in public policy in respect of climate action.

In respect of central banks, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) has noted that taking climate change into account in the context of monetary policy is still at an early stage.[16] While some important steps have been made, the NGFS noted that there is a common need among central banks to further improve their policy toolkits. Based on a survey carried out in the latter half of 2022, the NGFS identified that around 40% of respondents have already taken steps to integrate climate change considerations into their operational framework and many are considering further steps, in particular to protect their own balance sheets from climate-related financial risks.

[13] NGFS (2023a), *Report on climate-related litigation*, September 2023.
[14] NGFS (2023b), *Report on micro-prudential supervision of climate-related litigation risks*, September 2023.
[15] NGFS (2022).
[16] NGFS (2023c), *Monetary policy and climate change Key takeaways from the membership survey and areas for further analysis*, July 2023.

In identifying appropriate measures, central banks and supervisors will have to take into account their respective unique mandates and legal frameworks. This is necessary to ensure that that their mandates are fulfilled – but not exceeded – and that they comply with relevant procedural obligations.

The guidance and recommendations of international bodies, such as the NGFS, will be key in supporting central banks and supervisors in identifying, adopting, and communicating on suitable measures. For example, the NGFS has noted that disclosures will be key and has provided recommendations regarding central bank disclosures on governance, strategy and risk management, including target-setting.[17] Notably, in the area of governance, the NGFS recommended that if a climate-related disclosure is made, central banks should describe the implications of their legal mandates for their climate-related actions. Mandates define the legal parameters within which a central bank can operate and motivate their decisions. Mandates may constrain certain climate-related actions altogether. Differences in mandates and how these mandates are interpreted may thus explain why different central banks make different decisions regarding climate-related risks and opportunities. The NGFS outlined that the mandates of most central banks are centered around ensuring price stability as well as, in some cases, full employment and/or financial stability. Mandates might also require central banks to actively use policy instruments to support a transition to a net-zero economy. This can be the case if the central bank has an active sustainability mandate. In addition, it can be the case that the central bank has a mandate to support its government's economic policies. Moreover, the NGFS recommended central banks to disclose how governance structures around monetary policy, asset management, financial stability, and internal operations encompass climate-related risks and opportunities. In terms of strategy, the NGFS recommends that central banks disclose their strategies for identifying and assessing the inward and outward impacts of climate-related risks.

F. Sustainable finance

The progress of the international community, and bodies such as the NGFS, of regional bodies, and of national governments to develop legal frameworks to facilitate sustainable finance has been crucial. Such initiatives can support the flow of funding towards climate action and ensure financial markets properly price-in climate- and environment-related risks. The 2023 IPCC Report has noted that markets for green bonds, environmental, social and governance and sustainable finance products have expanded significantly since 2014, and noted that investors, central banks, and financial regulators are driving increased awareness of climate risk to support climate policy development and implementation.[18]

However, in view of the urgent need for action, and the risks to the financial sector, the momentum in driving forward sustainable finance needs to be maintained, and in some cases accelerated. These efforts need to take place at global, regional and national levels, to ensure compliance with the Paris Agreement, by supporting public and private investment in climate mitigation and adaptation, and by correcting market failures in the pricing of climate- and environment-related risks.

The private sector also has a role to play in addressing risk. Financial institutions and their supervisors need to properly investigate and price-in climate and environment-related risks, including litigation risk, and where necessary to adapt their operations and business models.

G. Conclusion

In view of the key legal considerations outlined above, the Committee on International Monetary Law decided to propose the adoption of a Resolution in respect of the climate emergency and decline in nature, and the financial sector. This Resolution calls on international institutions,

[17] NGFS (2021), *Guide on climate-related disclosure for central banks*, December 2021.
[18] IPCC (2023).

governments, central banks, supervisors, institutions in the financial industry, and the international legal community to do more to support and enable action through the financial sector, within their respective mandates and fields of influence. Such action is essential to ensure respect for the rule of law, in particular legally binding international commitments and fundamental human rights.

II. Climate change and central banks

A. Introduction

The impact of climate change and biodiversity loss on economic activities and the financial sector has led central banks and supervisory authorities to address the issues in their policies. As guardians of the currency and mandated to ensure price stability, many central banks have addressed the effects of climate change on their monetary policy. Likewise, supervisory authorities[19] have included the issue in their oversight of banks. The rapid growth in membership of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS)[20] shows that the topic has been taken up globally. Yet, there are marked differences among central banks in their approach, arguably due to differences in mandate.

B. Central banking

A remarkable change of attitude can be discerned at the **European Central Bank** (ECB): after positing for many years that pursuing its primary price stability mandate[21] suffices for it to adhere to its secondary mandate,[22] the ECB has expressly included its secondary mandate in its monetary policy strategy statement.[23,24] At the same time, the focus shifted from the secondary mandate[25] to its primary mandate when it comes to including climate change in the ECB's **monetary policy**. The ECB recognises the impact of climate change on price developments (climateflation), the cost of reliance on ever more expensive fossil fuels (fossilflation) and the upward push on prices due to obtaining scarce materials needed in the transition to a carbon-free economy (greenflation),[26] as well as potential shocks due to governments' uneven policies on the green transition.[27] The European Union's central bank has thus included climate change as a core element of its price-stability mandate.[28] This implies, thus far,

[19] For analytical purposes, the two functions (monetary policy, prudential supervision) are represented as belonging to separate institutions: central banks and supervisory authorities. Many central banks perform both functions.
[20] See: https://www.ngfs.net/en/about-us/membership.
[21] Article 127(1) Treaty on the Functioning of the European Union (TFEU), first sentence: "The primary objective of the European System of Central Banks (hereinafter referred to as 'the ESCB') shall be to maintain price stability".
[22] Article 127(1) TFEU: "Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union."
[23] Monetary Policy Strategy Statement, 8 July 2021.
[24] Michael Ioannidis, Sarah Jane Hlásková Murphy, Chiara Zilioli, The mandate of the ECB: Legal considerations in the ECB's monetary policy strategy review.
[25] Which would include following the EU's Green Deal and the EU Climate Law (Regulation (EU) 2021/1119 establishing the framework for achieving climate neutrality; Official Journal of the European Union, No. L 243/1, 9.7.2021). Also relevant is Article 11 TFEU which prescribes that "Environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development."
[26] *A new age of energy inflation: climateflation, fossilflation and greenflation*, speech by Isabel Schnabel, at a panel on "Monetary Policy and Climate Change" at The ECB and its Watchers XXII Conference, 17 March 2022.
[27] *Never waste a crisis: COVID-19, climate change and monetary policy*, speech by Isabel Schnabel, Member of the Executive Board of the ECB, at a virtual roundtable on "Sustainable Crisis Responses in Europe" organised by the INSPIRE research network, 17 July 2020.
[28] René Smits, *Elaborating A Climate-Friendly Legal Perspective For The ECB*, 7 September 2022, to be published, revised and updated, as *The ECB's mandate in the face of climate change and biodiversity loss* in a forthcoming book: René Smits (ed.), Sustainable Finance and Climate Change – Law and Regulation, Edward Elgar Publishing.

decarbonising its corporate bond holdings, distinguishing in collateral based on climate considerations[29] and taking climate specifically into account in monetary policy-underpinning research.[30] Current practice has come under fire[31] and further steps have been advocated,[32] including distinguishing between green transition and other activities in central bank lending.[33]

Such distinction is what the **People's Bank of China** (PBoC) undertakes, with its carbon emission reduction facility (CERF).[34] The PBoC's legal mandate differs from the ECB's in that it is to implement monetary policy autonomously[35] "under the leadership of the State Council". As the PBoC Governor made clear recently,[36] the Chinese central bank, in implementation of "President Xi Jinping's thoughts on ecological conservation", follows the *"30-60" Decarbonization Goal*, meaning "to peak carbon emissions before 2030 and achieve carbon neutrality before 2060". For this purpose, yet another instrument is employed, namely "special central bank lending for clean and efficient coal use". Financial institutions need to report on their carbon emission reduction loans for which they receive cheap central bank financing (60% can be financed at 1.75%).[37] Recently, ECB executive board director Frank Elderson suggested similar green lending: "whenever there is a monetary policy need in the future to reconsider targeted longer-term refinancing operations for banks, there are compelling reasons to seriously consider greening them" and, after comparing such refinancing to T-LTROs, added: "Similar targeting strategies can be considered to support green lending or exclude non-green lending in the future, provided an operationally efficient validation process is feasible."[38]

Another Asian central bank has also introduced a green lending scheme: the **Bank of Japan** introduced "Funds-Supplying Operations to Support Financing for Climate Change Responses".[39] Its mandate is linked to price stability and the sound development of Japan's economy.[40] Elsewhere in Asia, the **Reserve Bank of India**[41] has introduced[42] a "Framework for acceptance of Green Deposits", to enable Indian 'Regulated Entities' to offer deposits "the proceeds of which are earmarked for being allocated

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[29] Common minimum standards for incorporating climate change risks into in-house credit assessment systems in the Eurosystem, ECB Economic Bulletin, Issue 6/2022.

[30] ECB climate agenda 2022; see, also Our approach to our climate objectives.

[31] Yannis Dafermos, Daniela Gabor, Maria Nikolaidi, Jakub Gogolewski, Mauricio Vargas, (2023). *Broken promises: the ECB's widening Paris gap*, SOAS University of London; University of Greenwich; University of the West of England; Greenpeace, Broken promises: The ECB's widening Paris gap.

[32] Jens van 't Klooster, Eric Monnet, *Using green credit policy to bring down inflation: what central bankers can learn from history*, SOAS Centre of Sustainable Finance, LSE Grantham Research Institute on Climate Change and the Environment, 24 July 2023.

[33] "discrimination of refinancing facilities. More favourable interest rates may be offered for climate-friendly investments" are suggested to the ECB in a paper by Sonja Dobkowitz, Pia Hüttl, Alexander Kriwoluzky, Jana Wittich, *Climate Change and Monetary Policy: Risks, instruments, & chances*, Monetary Dialogue Papers, November 2023.

[34] PBoC press release, *The People's Bank of China Launches the Carbon Emission Reduction Facility*, 9 November 2021.

[35] Articles 2, 5, 7 of Law of the People's Republic of China on The People's Bank of China.

[36] Yi Gang, *Proactively implementing the philosophy of green development to peak carbon emissions before 2030 and achieve carbon neutrality before 2060*, Keynote speech by Mr Yi Gang, Governor of the People's Bank of China, at the 14th Lujiazui Forum "Global Financial Opening-up and Cooperation: New Drivers for Economic Recovery", Shanghai, 8 June 2023.

[37] This aspect resembles the ECB's Targeted Long-Term refinancing Operations (T-LTROs), a system under which banks on-lending to the real economy was financed at favourable rates. T-LTROs did not have a green purpose but were used to stimulate bank lending generally. See: https://www.ecb.europa.eu/mopo/implement/omo/tltro/html/index.en.html.

[38] *Monetary policy in the climate and nature crises: preserving a "*Stabilitätskultur*"*, speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at the Bertelsmann Stiftung, Berlin, 22 November 2023.

[39] BoJ, September 2021; see: https://www.boj.or.jp/en/mopo/measures/mkt_ope/ope_x/index.htm and https://www.boj.or.jp/en/mopo/mpmdeci/mpr_2021/rel210922a.pdf.

[40] Article 2, Bank of Japan Act, Act No. 89 of June 18, 1997, reads as follows: "The Bank of Japan conducts currency and monetary control, aiming at achieving price stability, thereby contributing to the sound development of the national economy."

[41] The mandate of which focuses on monetary stability and "to operate the currency and credit system of the country to its advantage", preamble to the Reserve Bank of India Act, 1934, as amended; see: https://www.indiacode.nic.in/bitstream/123456789/2398/1/a1934-2.pdf and https://www.rbi.org.in/commonperson/English/scripts/organisation.aspx.

[42] On climate change and India's response, see *Towards A Greener Cleaner India* - Inaugural Address by Dr. Michael Debabrata Patra, Deputy Governor, RBI at the New York Fed Central Banking Seminar organised by the Federal Reserve Bank, New York, on October 9, 2023, at New York.

towards green finance".[43] The **South African Reserve Bank**[44] intends to contribute[45] providing "support to improve information flows within financial markets so that climate change considerations inform investment decisions and maintain[ing] financial and price stability in the face of rising climate risks".

Provision of finance for the green transition at more favourable terms than other credit is often advocated, also beyond central bank refinancing: at COP28,[46] French President Emmanuel Macron called for the **private financial sector** to charge different interest rates between green and other projects and for rating agencies to reflect this in their rankings.[47]

In a different legal[48] and political environment, the American central bank focuses on financial stability and banking supervision when addressing climate change. In testimony before the US Gouse of Representatives[49], the US **Federal Reserve System** made clear that "the Federal Reserve's role with respect to climate change is important, but narrow. The Federal Reserve has a duty to understand risks to the safety and soundness of the banks it oversees and to the financial system, including the financial risks from climate change". There is no monetary policy-related approach, as the Fed's dual mandate is considered incompatible with a different stance.[50,51] It is only climate-related risks of banks that the Fed is taking into consideration in its supervisory role. Which brings us to the **prudential supervision** aspect of central banks and supervisory authorities involvement with climate change.

C. Prudential supervision

[43] RBI, 11 April 2023, at: https://www.pdicai.org/Docs/RBI-2023-24-14_1442023144322712.PDF.

[44] "The primary object of the South African Reserve Bank is to protect the value of the currency in the interest of balanced and sustainable economic growth in the Republic"; Article 3(1) of the South African Reserve Bank Act 90 of 1989.

[45] https://resbank.onlinereport.co.za/2022/downloads/Climate-change.pdf. See, also: *Climate change and policy coordination: What can central banks do?* A public lecture by Lesetja Kganyago, Governor of the South African Reserve Bank, at the Nelson Mandela University, Gqeberha, 19 October 2023.

[46] https://www.cop28.com/en/ and https://unfccc.int/.

[47] *Discours du Président de la République à l'occasion de la session plénière de la COP 28 de Dubaï*, 1 December 2023: *«C'est totalement absurde et donc notre marché privé, notre système d'investissement dysfonctionne massivement et c'est choquant pour tout le monde. On doit donc inverser le système. Il doit y avoir dans les prochaines années un taux d'intérêt en quelque sorte pour le vert, et un taux d'intérêt pour le brun. Et s'il y avait une priorité des financeurs, des agences de notation aujourd'hui pour être cohérents, ce serait de différencier ces taux d'intérêt, et qu'il y ait un vrai spread, parce qu'on n'intègre pas du tout le risque climatique.«.*

[48] The Federal Reserve Act, in section 2A, prescribes the following mandate: "The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates."

[49] *Climate-Related Financial Risks*, Michael S. Gibson, Director of Supervision and Regulation, 18 July 2023, Before the Subcommittee on Financial Institutions and Monetary Policy, Committee on Financial Services, U.S. House of Representatives.

[50] Emphasising distributional effects of policies that are the very essence of criticisms of central banks' unconventional policies (quantitative easing) and of traditional conduct of monetary policy which is considered confirmatory of a fossil-fuel bias. See the views expressed by Chair Jerome H. Powell at the Panel on "Central Bank Independence and the Mandate—Evolving Views", 10 January 2023, at the Symposium on Central Bank Independence, Sveriges Riksbank: "Addressing climate change seems likely to require policies that would have significant distributional and other effects on companies, industries, regions, and nations. Decisions about policies to directly address climate change should be made by the elected branches of government and thus reflect the public's will as expressed through elections."

[51] The fact that the ECB is a climate policy *taker* (not: *maker*) was also emphasised by the ECB: *Policymakers as policy takers – accounting for climate-related and environmental factors in banking supervision and monetary policy*, speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at the Peterson Institute for International Economics, Washington DC, 21 April 2023.

The NGFS, the Financial Stability Board (FSB)[52] and the Basel Committee on Banking Supervision (BCBS)[53] are involved in **international standard-setting**.[54] The NGFS's scenarios and publications[55] merit mentioning, as do the FSB's report on supervisory and regulatory approaches to climate risks[56] and the work of its Task Force on Climate-related Financial Disclosures (TCRFD), whose 2023 status report on "companies' progress in making climate-related financial disclosures" initiated its disbandment.[57] As of 2024, the IFRS Foundation will take over the work on disclosure, promoted through the International Sustainability Standards Board (ISSB).[58] Disclosures of climate-related risks by companies, and standards for such disclosures,[59] are important parameters for central banks and supervisors to base their own policies and risk assessments on.

Requiring banks and other financial institutions to monitor their exposure to climate and environmental risks has been an element of supervision for most central banks and supervisors for a number of years. Supervised entities are expected to **assess and adequately manage climate and environmental (C&E) risks**: physical risk, transition risk and reputational risk (climate litigation!), as African[60] and European[61] guidance makes clear. **Stress tests** are an essential element of the assessment of climate risk in the financial sector, in the EU[62] and the UK.[63] Supervisory action against banks considered not compliant with supervisory expectations of sound management of climate-related and environmental risk has been announced.[64]

With the risk of greatly overshooting the target of the Paris Agreement[65] to limit global warming to 1.5% compared to pre-industrial levels, as reported in the UN Environment Programme's Emissions Gap Report 2023,[66] one may expect ever greater supervisory emphasis on adequate risk management of C&E risks and more urgency in central banks' contributing to sustainable finance for the green transition.[67]

III. CBDCs and Cryptocurrencies

A. Introduction

[52] https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/.
[53] Notably, its Task Force on Climate-related Financial Risks (TFCR).
[54] Such as the BCBS's Principles for the effective management and supervision of climate-related financial risks, June 2022.
[55] https://www.ngfs.net/ngfs-scenarios-portal/ and https://www.ngfs.net/en/liste-chronologique/ngfs-publications.
[56] FSB, Supervisory and Regulatory Approaches to Climate-related Risks: Final report, 13 October 2022.
[57] https://www.fsb-tcfd.org/publications/#status-reports and https://www.fsb-tcfd.org/publications/.
[58] https://www.ifrs.org/sustainability/tcfd/ and https://www.ifrs.org/groups/international-sustainability-standards-board/.
[59] Prominently among which are the EU's Taxonomy Regulation (Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, Official Journal of the European Union, No. L 198/13, 22.6.2020), Sustainable Finance Disclosures Regulation (SFDR; Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector, Official Journal of the European Union, No. L 317/1, 9.12.2019) and forthcoming Corporate Sustainability Due Diligence Directive.
[60] See the Proposed Guidance on climate-related risk practices for banks, draft guidance from the South African Reserve Bank.
[61] See the ECB's Guide on climate-related and environmental risks Supervisory expectations relating to risk management and disclosure, November 2020.
[62] See https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.climate_stress_test_report.20220708~2e3cc0999f.en.pdf.
[63] The Bank of England's Biennial Exploratory Scenario (BES) exercise on financial risks from climate change; see: https://www.bankofengland.co.uk/news/2022/february/boe-launches-second-round-of-biennial-exploratory-scenario.
[64] *Making finance fit for Paris: achieving "negative splits"*, keynote speech by Frank Elderson, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at the conference on "The decade of sustainable finance: half-time evaluation" organised by S&D and QED, Brussels, 14 November 2023.
[65] See: https://unfccc.int/sites/default/files/english_paris_agreement.pdf and Official Journal of the European Union, No. L 282/4, 19.10.2016.
[66] Emissions Gap Report 2023, 20 November 2023.
[67] Rens van Tilburg, Aleksandar Simić and Sara Murawski, *The Climate Trillions We Need - Proposals for a new global financial architecture to end poverty and save the planet*, Sustainable Finance Lab Policy Paper, November 2023.

Both the decline in cash usage during the Covid-19 pandemic and the emergence of non-bank private sector digital money such as stablecoins and cryptocurrencies have accelerated central banks' work on their own digital currencies. Most central banks are exploring indeed central bank digital currencies (CBDCs), and more than a quarter of them are now developing or running concrete pilots.[68] In particular, work on retail CBDCs intended for use by the general public (rCBDCs) has advanced rapidly, and globally, more than two thirds of central banks are considering issuance of an rCBDC in the foreseeable future.[69] As technicians' and policymakers' work on CBDCs gathers pace, work is also progressing to consider the legal implications of their introduction and possible adaptations to legal frameworks to provide a certain but flexible digital monetary ecosystem in which CBDCs exist, as well as legitimacy and trust in their operation.

B. Central bank mandates

Legitimacy of an rCBDC is the foundation of the public's trust and social acceptance, so it must be absolutely clear that the central bank is acting within its mandate when issuing an rCBDC. However, this question can only be answered once design choices and legal classification of the CBDC are settled. In almost 80% of jurisdictions, the central bank law either lists specific types of money permitted to be issued (e.g. banknotes and coins), or the mandate to issue CBDC is unclear, with existing powers to open accounts, issue cash, operate a payment system or to preserve financial stability possibly providing a foundation for issuance, depending on the design choices made.[70] In many jurisdictions, central banks may wish to receive updated mandates to conclusively evidence the power to issue the rCBDC in the policymakers' preferred design.

C. Legal implications of design choices

Most central banks consider that an rCBDC would need to exist alongside existing forms of money, forming part of a menu of choices available to the public. However, before an rCBDC can be launched, its fundamental legal nature as compared to these other forms of money, and the private law rights to which such holdings give rise, must be clarified. However, this clarity can only be achieved when critical design decisions, including around architecture, holding limits, programmability and remuneration have been made.

- **Architecture**: many jurisdictions are considering a two-tier structure, with the central bank retaining full control over quantity, timing and amount of rCBDC issuances (and any redemptions), and with third party intermediaries, such as wallet providers, interfacing with the public. The central bank would likely enter into contractual relationships with these intermediaries who in turn would enter into contractual relationships with retail users, complemented by infrastructure rulebooks and procedures. Public law and regulations may impose conditions on those who can operate as intermediaries.
- **Holding limits**: it is generally assumed that an rCBDC would be intended for facilitating payments, and not for stockpiling or investing. Limits on rCBDC maximum holdings or anonymous transaction size would be consistent with this, and would preserve the intermediation role of commercial banks and help to maintain financial stability. Such restrictions may also help to mitigate AML/CFT risk, but they may make a currency less useful in the eyes of the public, and therefore threaten the singleness of money.
- **Remuneration**: an rCBDC could be remunerated through the payment of interest on holdings. Discrepancies in interest rates between traditional and digital cash would cause divergence in

[68] Kosee, A; Mattei, I. (2023). 'Making headway - Results of the 2022 BIS survey on central bank digital currencies and crypto', BIS Papers, 136.
[69] Ibid.
[70] Bossu, W. Itatani, M. Margulis, C. Rossi, A. Weenink, H.; Yoshinaga, A. (2020). "Legal aspects of central bank digital currency: Central bank and monetary law considerations", IMF Working Papers, SP/20/254, p. 21.

their value, and be inconsistent with the singleness of money. Designing the rCBDC as a deposit would imply a debtor-creditor relationship where the holder has a claim for cash.

- Programmability: rCBDCs offer potential benefits over existing forms of cash; for example, they can support conditional payments where settlement occurs automatically following satisfaction of certain pre-defined conditions. Full programmability (i.e. where units of the rCBDC can be used only for specific types of payment or within a certain timeframe or location) would be incompatible with legal tender status, and with fungibility at par with existing units of cash.

D. Legal classification of rCBDCs

Unlike a stablecoin, an rCBDC is not pegged to a fiat currency, it is the fiat currency. Emerging consensus is that it would be desirable for an rCBDC to be 'money' and, specifically, currency. This would allow their qualification as legal tender (if desired). Although legal tender status may enhance public acceptance of rCBDCs, it should not be a condition to their creation; many private means of payment that do not enjoy legal tender status are thriving. Legal tender status would also not substitute for a lack of social acceptance and usability. The question of whether an rCBDC needs legal tender status may therefore be answered in different ways.

Branding an rCBDC as 'digital cash' would assist with credibility and public acceptance. Despite this, cash could not be comingled with digital cash, and the legal method of their transfer and associated rights would necessarily be different. While the legal framework for such a CBDC could be based on that of cash, we cannot automatically apply the cash framework in its entirety.

As a sui generis instrument, rCBDCs do not generally fit neatly into the existing legal frameworks, which were built up in their absence. Surely then, once design and policy choices are settled, legal frameworks must evolve to reflect these new instruments. To try to fit a new sui generis instrument into existing legal frameworks might be tantamount to "put the cart before the horse", or to 'try to alter the geography to suit the map'. Design policy decisions should not be restricted by the scope of current legal frameworks.

Existing concepts such as settlement finality and monetary sovereignty may need to be updated accordingly. Existing privacy considerations are not necessarily applicable to the rCBDC world, although AML/CFT concerns and taxation continue to provide legitimate reasons for restricting rCBDC users' privacy. Transparency, record-keeping, and reporting of suspicious transactions will remain essential for the integrity of any financial transaction.

Lawmakers working to accommodate rCBDCs should remember that increased fragmentation of domestic legal frameworks will make global interoperability – the technical, operational and legal compatibility that enables one system to be used in conjunction with another - more challenging. Private international law rules must establish how ownership and other rights in CBDCs can be transferred. The existing patchwork of legal arrangements is complicated and expensive, with AML/CFT enforcement challenging. The introduction of CDBCs offers a unique opportunity to revolutionise cross-border payments. International cooperation is therefore critical.

E. Regulation of cryptocurrencies

The success of any CBDC will depend on its context within the broader monetary ecosystem. As work on rCBDCs progresses, policymakers must distinguish them from so-called cryptocurrencies to obtain trust from the public. Cryptocurrencies do not offer the protection of a central bank, a reliable regulatory framework or finality of payments. Their extreme volatility and primary function as investments mean that they should not be classified as 'currency'.

Other private forms of money, such as stablecoins, have monetary potential, provided they are properly regulated. Regulators are likely to want to specify what types of entities may issue a stablcoin, and what reserve requirements apply. A specific resolution regime is likely to be required.

As the landscape of digital money evolves, more granularity in regulation will be required. The Basel Committee on Banking Supervision reviewed various elements of the prudential standard for banks' exposures to cryptoassets published in December 2022. It agreed to consult on potential revisions of the criteria for stablecoins to receive a preferential "Group 1b" regulatory treatment, but concluded that cryptoassets that use permissionless blockchains create risks that cannot be sufficiently mitigated at present and therefore agreed to retain the existing treatment for such cryptoassets.

F. The unified ledger

The global monetary system stands on the cusp of making a major leap of which CBDCs form just one part. The BIS' 2023 Annual Economic Report 5 presents a blueprint which envisages CBDCs being brought together with other tokenised assets in a new type of financial market infrastructure – a 'unified ledger'. Tokenisation is the process of representing claims digitally on a programmable platform, such as a blockchain. In simple terms, a unified ledger could be considered a 'common venue' where money and other tokenised objects – including CBDCs, shares or real estate – coexist on the same programmable platform. We can imagine one unified ledger aimed at improving securities settlement, while another could facilitate trade finance in supply chains. Representing and transferring assets in this way could support simultaneous and instantaneous settlement, reducing settlement times and credit risks. Settlement in central bank money would maintain the singleness of money and payment finality. Tokenisation, and in particular, the unified ledger, has the potential to trigger a step-change in the monetary and financial system, allowing participants to interact in new ways, improving the old and enabling the new.

IV. Central Banks: Communication and Accountability[71]

A. Introduction

Accountability is a critical corollary of central bank independence. And communication is a necessary component of accountability. However, this was not always the case. Janet Yellen recalls that

> *"Montagu Norman, governor of the Bank of England in the early 20th century, reputedly lived by the motto never explain, never excuse, and that approach was still firmly in place at the Federal Reserve when I went to work there as a staff economist in 1977."*[72]

From the early 1990s till the Global Financial Crisis (GFC) the central banking model that characterized the Bundesbank (a model which influenced the design of many central banks around the World including the ECB),[73] was in line with the so-called "Tinbergen rule" of one agency (the central bank), one primary objective (price stability) and one main instrument (interest rate policy). The alignment

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[71] This part partially draws on Rosa Lastra and Sara Dietz on "Communication in Monetary Policy", prepared at the request of the European Parliament (ECON) in preparation for the Monetary Dialogue of February 2022. An abridged version of it was published at Just Money.

[72] Janet Yellen , *"Communication in Monetary Policy"* speech at the Society of American Business Editors and Writers 50th Anniversary Conference, Washington, D.C, 4 April 2023.

[73] Markus Brunnermeier, Harold James & Jean-Pierre Landau, *The Euro and the Battle of Ideas* (Princeton, N.J.: Princeton University Press, 2016) at 66, 67-82 argue that the German approach, shared by northern EU Member States, is characterized by a focus on legal, moral, and political foundations of free markets expressed in clearly articulated rules; a strong emphasis on responsibility and accountability; a belief that binding rules are needed to shield monetary policy from fiscal dominance; a strict approach to government debt and debt ceilings; a conviction that growth is not achieved by provision of additional money but by structural reforms and a belief that present virtue—austerity—will be rewarded by future benefits.

between the primary objective and the main instrument reflected a general consensus on what central banks should do.[74]

However, as this model started to unravel with the addition of new powers, the reliance on unconventional monetary policy measures (such as Quantitative Easing[75] and forward guidance[76]), the renewed emphasis on financial stability, and the role of central banks as 'crisis managers' – first with regard to the GFC and the ensuing sovereign debt problems, then with the Covid-19 pandemic and now even with climate change – the expanded remit of central banks brings them closer to the political arena. In this new world, the need for independent central banks to give account, to explain and to communicate clearly the trade-offs and tensions between objectives is of paramount importance to preserve their credibility and legitimacy.

The relationship between monetary and fiscal policy, the complex interaction between the solvency of banks and the solvency of sovereigns, the changing nature of systemic risk, create complex dynamics for which independent central banks as technocratic institutions must be held accountable.

Accountability is not simply an 'add-on' to justify central bank independence. Hence the term 'accountable independence'.[77] Independence without accountability would be like freedom without responsibility. But the design of accountable independence is a balancing act which varies across jurisdictions, depending on the legal tradition, level of economic and financial development, respect for the rule of law and others. Too much independence leads to an undesirable state within the state. Too much accountability threatens the effectiveness of independence.

B. Dimensions of accountability

Accountability has different dimensions: institutional/political and technical/performance. Lawyers typically give emphasis to the former, in line with the *trias politica* principle (bringing back the central bank to the democratic system of checks and balances).[78] Economists, while mindful of the importance of parliamentary accountability and audit control, pay close attention to performance and to disclosure (transparency as a market-based form of accountability). 'Performance accountability' is easier to achieve when there is one objective rather than several objectives, and when the objective is narrowly defined, rather than broadly defined. In the case of several objectives, it is facilitated when there is a clear ranking of objectives.

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[74] See generally Rosa Lastra & Peter Conti Brown, *Research Handbook on Central Banking*, (Elgar: London, 2018). See also Charles and Rosa Lastra, "Populism and Central Bank Independence", Open Economics Review, 2017, https://link.springer.com/article/10.1007/s11079-017-9447-y; and Charles Goodhart and Rosa Lastra, "The Changing and Growing Roles of Independent Central Banks now do require a Reconsideration of their Mandate, Accounting, Economics" (27 February 2023) https://eprints.lse.ac.uk/118448/1/10.1515_ael_2022_0097.pdf.

[75] See House of Lords Report on *Quantitative easing: a dangerous addiction?* (2021).

[76] Forward guidance as a new tool of monetary policy relates to the central bank's communication of the projected path of monetary policy. But it can impose unnecessary constraints. During the House of Lords inquiry into the independence of the Bank of England (2023) Economic Affairs Committee - Oral evidence transcripts - Committees - UK Parliament forward guidance was criticized by Martin Wolf and Paul Tucker as 'institutionalized groupthink'.

[77] Rosa Lastra "The Independence of the European System of Central Banks", Harvard International Law Journal, Vol. 33, No. 2, 1992, pp. 475-519 and Rosa Lastra, Central Banking and Banking Regulation (LSE, 1996), chapter 1.

[78] See Fabian Amtenbrink and Rosa Lastra, 'Securing Democratic Accountability of Financial Regulatory Agencies – A Theoretical framework' in *Mitigating Risk in the Context of Safety and Security. How Relevant is a Rational Approach?* edited by R.V. de Mulder (Rotterdam: Erasmus School of Law & Research School for Safety and Security (OMV) 2008, pp 115-132, ISBN 987-90-5677-0686-6, page 121. See also Rosa Lastra and Marco Bodellini, Independent Accountability Mechanisms Network (IAMnet).

In line with the nature of delegated powers[79], the holder of power must explain and justify the actions or decisions taken ('explanatory accountability'), answer difficult question and give reasons; and where error is proved or harm inflicted make amends and/or grant redress ('amendatory accountability'). Monetary policy accountability is typically explanatory while supervisory accountability is also amendatory.[80]

A further twist to understand the notion of accountability is the distinction between *ex ante* and *ex post* mechanisms. Accountability can either be exercised before/during the process of taking the decision/action, *or* after the decision/action has been taken. For instance, the appointment procedures of central bank officials, when such procedures require parliamentary approval – for example, the advice and consent of the Senate in the appointment of the Chair and Vice Chair of the US Federal Reserve System – constitute a form of *ex ante* accountability. The reporting requirements and the appearances of the central bank chairman, president or governor in front of parliamentary committees are ways of exercising accountability through control or *ex post.*

C. Accountability, transparency, and communication

Accountability and transparency are essential to reconnect normative legitimacy with societal legitimacy.[81] In particular, when central banks fall short of achieving their primary mandate (like their failure to identify the return of more persistent rather than transitory inflation since 2021), they need to explain and justify in front of Parliament why and how they failed. Was it groupthink? Was it a failure of the models? Was it because of ignorance of money supply considerations? Or what other elements influenced their decisions?[82] Central banks also need to manage the expectations of financial markets and households and explain the reasoning leading to their decisions. Such reasoning and proportionality assessment become crucial in jurisdictions where central bank monetary policy decisions are justiciable, as is the case with the ECB.[83]

But if the central bank oversteps its mandate, or if it is perceived to do so, credibility is damaged and legitimacy can be endangered, thus undermining the trust in the commitment of the central bank to keep inflation under control. If this trust is eroded, it will only be a question of time until the degree of independence gets questioned. After all, independence is not a goal in itself but an instrument in the pursuit of a goal (or set of goals). If the goal is questioned, then independence will also be questioned; hence the need for adequate communication. Indeed, communicating clearly and effectively with political leaders and legislators, financial markets and public opinion is part and parcel of the job of today's central bankers.

"Communication plays different functions: (1) "reflection", in which the institution itself gives an account of its own tasks as they evolve over time; (2) "translation", explaining in common parlance to the public the measures adopted (a feature of social media) or the meaning of concepts such as "the transmission mechanism" of monetary policy; (3) "management of expectations" essential in the

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[79] "Responsibility should, indeed, be commensurate with the extent of the power possessed". See C. Turpin, "Ministerial Responsibility", Chap. 5 of J. Jowell & D. Oliver (eds.) *The Changing Constitution* (Oxford and New York, 1994).

[80] Rosa Lastra, "Accountability Mechanisms of the Bank of England and of the European Central Bank" (2020), *European Parliament*.

[81] See Amaryllis Verhoeven, *The European Union in Search of a Democratic and Constitutional Theory* (The Hague: Kluwer Law International, 2002) at 10-11. See also Rosa M. Lastra and Heba Shams, 'Public Accountability in the Financial Sector', in Eilís Ferran and Charles A.E. Goodhart (eds), *Regulating Financial Services and Markets in the Twenty First Century* (Oxford Hart Publishing 2001) 165-188.

[82] This was the subject of the inquiry on the operational independence of the Bank of England conducted by the Economic Affairs Committee (EAC) of the House of Lords. The final evidence-based report was published in 2023, with the title "Making an independent Bank of England work better".

[83] Though accountability is always important, it can become a routine exercise in ordinary times. Accountability is, however, essential in extraordinary times. See Rosa Lastra and Geoffrey Miller, "Central Bank Independence in Ordinary and Extraordinary Times", Chapter 3 in Jan Kleineman (ed.), *Central Bank Independence. The Economic Foundations, the Constitutional Implications and Democratic Accountability*, Kluwer Law International, The Hague, 2001, pp. 31-50.

communication with financial markets and the public; (4) "listening" to the various stakeholders – a function of "education" and "legitimisation" whereby an independent technocratic agency explains why its actions serve its goal (or goals) and how it stays within the boundaries of its mandate."[84]

V. Economic Sanctions

A. Introduction

Over the past two decades, international sanctions have become an increasingly common foreign policy tool. They are used to address breaches of international law or conflict situations, to promote democratic values and to oppose any other undesirable conduct of a sanctioned person or entity. Recent developments indicate a significant evolution in sanctions' practices, more particularly within the context of unilateral economic sanctions, which, unlike the UN Security Council's multilateral sanctions, are adopted by States or regional organizations like the European Union (EU).

Specifically, the monetary and financial dimensions of these restrictive measures have become critical components of sanctions strategies. A wider range of monetary and financial assets, entities (including central banks), and services are now targeted. Financial institutions, infrastructures, regulators, and even central banks play an increasingly influential role in shaping sanctions channels. Furthermore, sanctions have implications for financial contracts and intersect with money laundering and terrorist financing disciplines, resulting in complex legal challenges.

MOCOMILA has discussed these issues on numerous occasions and also compiled a book titled *International Sanctions – Perspectives on Monetary and Financial Law,* edited by Chiara Zilioli, Régis Bismuth and Luc Thévenoz. The book is set to be published in 2024.[85] Members of the committee, alongside distinguished experts in the field, have contributed to the 18 chapters of this book, which reflects a number of topics that have been discussed in the Committee.

B. Money and Finance: The New Frontiers of International Sanctions

Sanctions regimes have progressively incorporated monetary and financial dimensions. Since the turn of the 21st century, the tendency has been to move away from broad and indiscriminately applied economic sanctions and towards targeted sanctions, often of a financial nature – although the extensive sanctions recently imposed on Russia and Belarus may indicate a reversal of this trend.

In terms of chronology, financial sanctions have evolved from an uncommon measure during the Cold War into a core tool of foreign policy and economic statecraft since 1990, and one that has moved from comprehensive embargoes against nation-states towards targeted and increasingly prescriptive sanctions also against non-state actors. At EU level, in particular, financial sanctions evolved from the joint adoption of sanctions against Argentina in the context of the Falkland Islands conflict to the series of sanctions following Russia's full-scale invasion of Ukraine. The thorny legal path from freezing to confiscating assets or financing Ukraine's reconstruction from frozen Russian assets is associated with additional legal and political challenges.

One basic element of sanctions' discussions revolves around the weaponization of money and payments, in particular in light of the US dollar's 'exorbitant privilege' as an anchor in international

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[84] Above note 71. See generally Douglas Holmes, "*Economy of Words/ Communicative Imperatives in Central Banks*" (Chicago: University of Chicago Press, 2014). Holmes explains how and why central bankers have learnt "to talk to markets" for only by effectively communicating with markets, can they justify their monetary policy decisions. At 29 Holmes claims that "to understand the economy at large, it must be viewed as operating across an intricate communicative field".

[85] Chiara Zilioli, Régis Bismuth & Luc Thévenoz (eds.), *International Sanctions – Perspectives on Monetary and Financial Law* (Brill, forthcoming 2024).

monetary relations. The development of unilateral sanctions will likely dilute the dominance of the US Dollar and result in further diversification of central bank reserve assets and a more fragmented international monetary system. Although the Belgium entity 'Society for Worldwide Interbank Financial Telecommunications' (SWIFT) enjoys a de facto global monopoly in payments, sanctions incentivise some countries to make their payments outside SWIFT. Countries like Russia and China have stepped up efforts to develop alternatives to the SWIFT payment system and parallel monetary and payment systems such as Russia's initiative System for Transfer of Financial Messages (SPFS), China's a Cross Border Interbank Payment System (CIPS) and its Digital Currency Electronic Payment (DCEP), herald the emergence of a parallel monetary and payment system.

When it comes to the issue of extraterritoriality, the EU originally strongly condemned the extraterritorial application of certain US sanctions. In a more recent period, accelerated by Russia's full-scale invasion of Ukraine, the EU has gradually expanded the geographical scope of its restrictive measures, requiring in practice an increasingly less direct connection to the EU. This expansion is apparent in nearly all aspects of individual sanctions and trade controls with the EU private sector, beginning with financial institutions. The expanded reach of EU sanctions relays new groundwork for the potential extraterritorial application of EU law in a broader context.

When it comes to the UK's financial sanctions framework, post-Brexit the UK has developed an independent and autonomous sanctions regime. The key Sanctions and Anti-Money Laundering Act 2018 constitutes the cornerstone of the UK's new sanctions framework – and the Economic Crime (Transparency and Enforcement) Act 2022. It ends by reflecting on some of the emerging differences between the UK's sanctions regime and those of other jurisdictions, with a particular focus on that of the EU.

C. Sanctions and central banks

Central banks have become key actors in sanctions regimes, either because they have been targeted by restrictive measures or due to the emerging role they play in their implementation. One of the central issues is that of central bank immunity. Although the sanctions against Russia's central bank are unprecedented in scope, the US has previously imposed sanctions on the assets of the Afghan, Cuban, Iranian, North Korean, Sudanese, and Venezuelan central banks, raising questions of sovereign immunity.

The possibility of using frozen and immobilised assets (including those of the Central Bank of Russia) for the financing and reconstruction of Ukraine opens a new chapter in these discussions. While seizing the assets of the Central Bank of Russia faces significant legal obstacles (right to property, State immunity, etc.), their use – namely, disposing of the revenues generated by custodians as a consequence of the investment of the assets – may offer a promising alternative legal avenue. This avenue has been the object of recent proposals by the Union legislators.

Additional limitations to sanctions against central banks stem from fundamental rights, both substantive (such as the right to property) and procedural (such as the right to be heard). According to the well-settled case law of the Court of Justice of the European Union, foreign central banks benefit from the rights protected by the EU Charter of Fundamental Rights. This requires EU institutions to treat foreign central banks as beneficiaries of fundamental rights (including those under the European Convention on Human Rights) when imposing restrictions on their activities.

The findings of the Iran-United States Claims Tribunal in an arbitration decision issued in November 1999 shed important light in the treatment of central banks under sanctions. The case arose from the Federal Reserve sanctions' targeting the Central Bank of Iran's (Bank Markazi) assets following the Iranian Hostage Crisis. The tribunal upheld the legality of the sanctions and addressed the determination of a reasonable interest rate on the frozen assets. Certain of these principles could be applicable to potential future claims involving the Central Bank of the Russian Federation and frozen Russian assets, anticipating significant third-party creditor claims and the need for a tribunal to manage asset distribution.

Central banks also act as public authorities, applying restrictive measures in the exercise of their powers. At EU level, the ECB, the national central banks and the national competent authorities are obliged to comply with the sanctions decided by the EU legislator. The ECB implements sanctions in monetary policy and prudential supervision and engages in international coordination to guarantee sanction effectiveness. The ECB's obligation to comply with EU sanctioning decisions might encounter limits, where sanctions could interfere with the independent exercise of the ECB's mandate or in case of conflicts with the Charter of Fundamental Rights or international law.

The Sberbank cases highlight issues focusing on financial stability. Significant deposit outflows from Sberbank Europe AG (a subsidiary of Sberbank of Russia, whose majority shareholder is the Russian Federation) and its Croatian and Slovenian subsidiaries led the ECB to act to preserve financial stability, protect bank depositors and prevent negative externalities in the euro area banking system. The ECB assessed that these credit institutions, which it had identified as 'significant', were failing or likely to fail in accordance with the applicable resolution framework. Resolution measures were activated by the Single Resolution Board.

D. The Impact of Sanctions on Contractual Rights and Property

Sanctions imposed by one State may affect commercial and financial disputes coming for decision before the courts of other States or international arbitral tribunals. They may have direct or indirect effect extraterritorially (e.g.) by way of the law governing a transaction, or as part of the law of the place of its performance, or arguments may be advanced that public policy issues are engaged. Monetary sovereignty does not in itself imply extraterritorial recognition of sanctions imposed under the law of the issuing state (*lex monetae*). However, this principle may have to be revisited if Central Bank Digital Currencies (CBDCs) are adopted.

The contractual consequences of sanctions before the English courts, emerged in recent judicial decisions, including the *Mints* and *Litasco* cases. The doctrines of frustration and supervening illegality appear to have lead to appropriate results in this type of situation. The case on force majeure clauses appears to be more complex. In particular, the obligation to endeavour to mitigate the effect of sanctions legislation may tend to promote a mentality of avoidance or circumvention. Market standard clauses designed to provide a framework for dealing with the imposition of sanctions tend to be fairly rudimentary. However, there is a limit to what contractual drafting can achieve in this area since the operation of such clauses will frequently be overridden by the mandatory nature of sanctions regulations.

The EU Blocking Regulation, which prohibits EU operators from complying with certain US sanctions, is another important aspect in this debate. Third-country sanctions – and mostly US extraterritorial ones – expose parties to significant risks of damage and even criminal liability, which are often unforeseeable or even unavoidable. The risk of damage is particularly evident when third-country authorities or parties have access to assets of EU entities outside the EU, or when third-country intermediaries such as banks are involved in the execution of payment orders. As a result, economic operators are building unilateral and extraterritorial sanctions into their compliance programmes. This is likely to lead to a phenomenon of over-implementation of unilateral and extraterritorial sanctions, despite their questionable legitimacy and legality.

Many innovative sanctions designed by the EU and followed by a few other jurisdictions, such as the ban on trust services for Russian individuals and companies, deserves closer critical scrutiny. Designed to target private trusts for wealthy Russian individuals, such measures have unintendedly affected many other trusts that have other commercial or financial purposes and should not fall within the scope of the measure. The UK sanction on trust services, which was adopted nine months after the EU restriction, addresses several problems that are not satisfactorily resolved under EU law. Contrary to expectations, the problems affect not only Russian settlers, beneficiaries, and trustees, but also all European financial institutions that service trust assets. An excessive restriction on trust services creates a competitive hurdle for the European banking and financial industry. The policy for restricting trust services should be more thoroughly clarified and its material scope should be narrowed in line with this policy.

Financial institutions have also a critical role in implementing asset-freezing measures against Russian individuals and entities. Decision 2014/145/CFSP and Regulation 269/2014 now target over 1000 individuals and entities. The implementation of restrictive measures, specifically the freezing of funds and economic resources and the prohibition from making those assets available, primarily falls on financial institutions, raises many legal issues, including identifying the financial institutions involved, clarifying the specific objectives of the measures, determining the exact targets, and understanding the full legal effects of these actions.

VI. Judicial Review of Banking Supervision

A. Introduction

Review of banking supervisory decisions takes place in different fora, on which the scope of review often depends. Certain features of supervisory regulatory frameworks shape both supervisory decisions and their judicial review. In particular, the EU framework and the Single Rulebook have led to a peculiar situation where national and EU courts scrutinize decisions by national and EU supervisors based on both EU and domestic laws. These procedures are intertwined and heavily connected, which leads to complexities.

B. The acts of bank supervisors before domestic courts

In the EU, decisions of the Court of Justice of the European Union (CJEU) in the way of preliminary rulings, often revolve around the question of EU law and its implementation in the national regulatory framework. There are observable regional differences in litigation proneness. For example, the French banking industry has taken to the courts repeatedly on various issues. There are cases from the Baltic States, Italy, Spain, Malta, Greece, Austria, and Portugal. However, most Eurozone States have had no cases so far. Judicial review before domestic courts has concerned many topics across the Single Rulebook, including license withdrawal, fines, authorisation of qualifying holdings, access to documents, application of supervisory measures, FOLTF assessments, and national prudential measures.

The ECB and other supervisors enjoy considerable discretion in their supervisory tasks. Thus, EU Courts take a deferential approach and mainly consider whether an error in law has been made, a manifest error of assessment or misuse of powers, or whether the supervisor exceeded the bounds of their competence. Moreover, they consider whether the supervisor adhered to its due process obligations, whether the supervisor stated its reasons sufficiently and whether the facts on which a contested decision was based were accurately set out. Therefore, there are only a few cases of annulment of supervisory decisions.

In the *Crédit Lyonnais* case (Case 389/21 P), the CJEU reviewed the General Court's judgment on an ECB decision (where the ECB refused to grant authorisation to exclude the exposures of certain exposures from the calculation of its leverage ratio). The CJEU clarified that 'in so far as the ECB has a broad discretion […], the judicial review which the Courts of the European Union must carry out of the merits of the grounds of a decision such as the decision at issue must not lead it to substitute its assessment for that of the ECB, but seeks to ascertain that that decision is not based on materially incorrect facts and that it is not vitiated by a manifest error of assessment or misuse of powers.'[86] 'Where an institution enjoys broad discretion, observance of procedural guarantees is of fundamental importance, including the obligation for that institution to examine carefully and impartially all the relevant aspects of the situation in question'.[87] However, since 'the General Court did not review the manifest error of assessment as was incumbent on it, […] but substituted its assessment for that of the ECB in a situation, moreover, in which, that institution enjoys a broad discretion',[88] the CJEU set aside the judgment.

Thus, it will be interesting to observe the pending appeals procedure in the *Corneli* case (Case T-502/19), where the General Court annulled the ECB decision to put Banca Carige into special administration (appeals are pending; Case C-777/22 P). The decision also focused on the relationship between EU law and national laws and the Single Rulebook, with the combination of EU directives and national legislation transposing it, and the ECB ultimately applying the law: The Court stated that 'the obligation to interpret national law in conformity with EU law that has just been recalled cannot serve as a basis for an interpretation which runs counter to the wording used in the national measure transposing a directive.'[89]

Another interesting feature of the European system is the 'composite procedure' consisting of preparatory acts by national competent authorities (NCAs) and the procedure and decision on the side of the ECB. If the ECB's decision is challenged before EU courts, the decision can also be challenged because of defects in the preparatory procedure before the NCA. In this regard, the CJEU held in the *Berlusconi* case (Case C-219/17) that defects in the national competent authority's procedure before ECB decision can only be assessed by the CJEU in action against ECB decision:[90] 'Consequently, it must be held that the EU Courts alone have jurisdiction to determine, as an incidental matter, whether the legality of the ECB's decision of 25 October 2016 is affected by any defects rendering unlawful the acts preparatory to that decision that the Bank of Italy adopted. That jurisdiction excludes any jurisdiction of national courts in respect of those acts, and it is irrelevant in that regard that an action such as the *azione di ottemperanza* has been brought before a national court.'[91]

In her Opinion on the *Pilatus Bank* cases (Cases C-750/21 P and C-256/22 P), Advocate General Juliane Kokott argued that alleged deficiencies in Maltese preparatory acts, not contestable before national courts, should be attributed to ECB to ensure respect for fundamental procedural rights under EU law (para 75) and that ECB should apply full legal scrutiny of NCA proposals for license withdrawal about proportionality, procedural rights (para 108).[92] In its recent decisions in the cases of 8 February 2024

[86] *Crédit Lyonnais* case [C-389/21 P], Judgment of the Court (First Chamber, 4 May 2023, para 55 (emphasis added).
[87] id, para 57 (emphasis added).
[88] id, para 72 (emphasis added).
[89] *Corneli* case [T-502/19], Judgment of the General Court, 12 October 2022, para 106.
[90] *Berlusconi* case [C-219/17] Judgment of the Court, 19 December 2018, para 59: 'Article 263 TFEU must be interpreted as precluding national courts from reviewing the legality of decisions to initiate procedures, preparatory acts or non-binding proposals adopted by CNAs in the procedure provided for in Articles 22 and 23 of CRD IV, in Articles 4(1)(c) and 15 of the SSM Regulation and in Articles 85 to 87 of the SSM Framework Regulation and that it is immaterial in that regard that a specific action for a declaration of invalidity on the ground of alleged disregard of the force of res judicata attaching to a national judicial decision has been brought before a national court.'
[91] id, para 57.
[92] *Pilatus Bank* cases [C-750/21 P and C-256/22 P], Opinion of Advocate General Kokott, 25 May 2023. para 72: 'The possible unlawfulness of (preparatory) acts of national authorities, such as an infringement of the rights of defence, 'contaminates' the ECB decision at issue and is attributable to the ECB. This contamination is consistent with the principle that implementing or preparatory acts that cannot be independently challenged should, at least, be reviewed as to their legality together with the decision bringing the administrative proceedings to an end and are capable of rendering that decision void. In the composite administrative proceedings for withdrawing authorisation, this principle also takes account of the fact that the ECB has sole responsibility for granting a fair hearing with regard to the decision concluding the proceedings.' (notes omitted, emphasis added).

(Case C-750/21 P and Case C-256/22 P), the CJEU did not need to pronounce on that matter to decide the dispute and thus did not pick up on this issue.

Some cases on intriguing issues are still pending and will hopefully clarify the interplay between national and EU regulators. Some of these include the application of national supervisory measures (*e.g. BAWAG* [Case T-667/21] and *Sberbank* cases [Case T-647/21; Case T-99/22] on the imposition of absorption interest) or the access to ECB documents (*e.g. Corneli* [Case T-501/19] and *Malacalza Investimenti* cases [Case T-552/19]).

The European Banking Institute keeps an overview of cases on its website.

C. The acts of bank supervisors before investment tribunals

Relevant treaty standards for the assessment before investment tribunals include fair and equitable treatment (FET), Full Protection and Security (FPS), Expropriation (direct and indirect), and Non-discrimination (ND) / National Treatment (NT) - though a cross-cutting analysis, encompassing multiple treaty standards, might be necessary to assess the supervisor's action (e.g. continuity FET/indirect expropriation, or taking ND into account for an evaluation of the FET standard).

Domestic law principles of administrative responsibility of financial regulators and supervisors provide background and guidelines for arbitral decisions, for example, gross negligence/misconduct in France (*faute lourde*), recklessness in the UK, the principle that supervisors must act within the limits of their discretionary activity in Italy and principles of discretionary function exception, or from FTCA litigation in the US.

Moreover, policy considerations inevitably factor into questions of supervision decisions: It might be desirable not to second-guess administrative decisions based on policy choices, there are concerns about moral hazard, and both complexity and flexibility of financial regulation and supervision as well as considerations of financial stability must be taken into account.

This also connects to the prudential carve-out in trade and investment agreements, e.g. GATS' Annex on Financial Services, which states that '[n]otwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policyholders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system.'[93]

Finally, the Basel Committee on Banking Supervision's Core Principles for Effective Banking Supervision provide international standards on the responsibility of banking supervisors: 'The legal framework for banking supervision includes legal protection for the supervisor.'[94] (…) 'Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.'[95]

Standard of review

The standard of review under international investment agreement (IIA) standards is limited. Arbitral tribunals afford deference to the banking supervisor and do not second-guess the supervisor's decisions.

[93] General Agreement on Trade in Services, Annex on financial services, Article 2 para a.
[94] Basel Committee on Banking Supervision, Core principles for effective banking supervision, Principle 2.
[95] id, Principle 2, Essential Criterion 9.

This is reflected in arbitral awards such as *Invesmart v Czech Republic*[96] or *Bank Melli v Bahrain.*[97] However, tribunals evaluate whether the supervisor's measures are motivated by bona fide regulatory objectives[98] and whether there has been an excess or abuse of discretion.[99] There must also be a rational link between the measures and their intended objectives.[100]

Regulatory Framework as the Matrix of the Supervisor's Actions

The banking supervisor should act within the limits of the domestic/regional regulatory framework. Tribunals have acknowledged that the supervisor (as an organ of the Respondent state) acts within a margin of discretion in banking regulation set out by the legal framework (in the case of the EU within the EU's Single Rulebook, comprising EU law and the relevant domestic law).[101]

Certain regulatory frameworks accord discretion to the supervisor, who also questions whether to exercise a specific competence to which it is empowered and to act in a specific manner. For instance, tribunals have considered the failure or omission of granting an Emergency Liquidity Assistance (ELA)[102] or enacting a ban on short sales of the bank's shares.[103] Moreover, the framework in that case did not oblige any state actor, including the supervisor, to take specific steps to prevent Spanish entities and municipalities from withdrawing their funds from the Claimant's accounts.[104]

In contrast, certain regulatory frameworks can be taken as requiring a specific behaviour from the supervisor or exploring alternative measures before taking a specific action. In *Bank Melli v Bahrain*, the tribunal held that the regulator should have considered less restrictive measures than administration and liquidation. The failure to do so led to the measures being qualified as non-bona fide regulatory measures.[105]

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[96] Award, 26 June 2009, para 501: 'A decision to revoke a bank's licence (…) is not reviewed at the international law level for its "correctness", but rather for whether it offends the more basic requirements of international law. […] when testing regulatory decisions against international law standards, the regulators' right and duty to regulate must not be subjected to undue second-guessing by international tribunals. Tribunals need not be satisfied that they would have made precisely the same decision as the regulator in order for them to uphold such decisions.' (emphasis added).

[97] PCA Case No 2017-25, Award, 9 November 2021, para 636: '[T]he Tribunal agrees with the Respondent that it owes a certain degree of deference to the State's specialized regulatory organ, the CBB. Indeed, the Tribunal cannot sit in judgment of every procedural or substantive error of the regulator, or else it would encroach on the function of an administrative review body or an appellate court.' (emphasis added).

[98] *De Levi v Peru,* ICSID Case No ARB/10/17, Award, 26 February 2014, para 475, citing *Suez and Vivendi v Argentina (II),* ICSID Case No ARB/03/19, Decision on Liability, 30 July 2010, para 139: '[I]n evaluating a claim of expropriation, it is important to recognize a State's legitimate right to regulate and to exercise its police powers in the interests of public welfare and not to confuse measures of that nature with expropriation.' (emphasis added)

[99] *Antonio del Valle Ruiz v Spain*, PCA Case No 2019-17, Final Award, 13 March 2023, para 584: '[A] failure to enact a ban would be arbitrary if the supervisor's decision was based on an excess or abuse of discretion, on prejudice or personal preference, or if it was taken for reasons other than those put forward by the decision maker.' (emphasis added).

[100] *Bank Melli v Bahrain*, PCA Case No 2017-25, Award, 9 November 2021, para 651: '[T]he Tribunal is persuaded that Bahrain's measures against Future Bank were not genuine regulatory measures aiming at addressing Future Bank's unlawful conduct.' (emphasis added).

[101] *Antonio del Valle Ruiz v Spain*, PCA Case No 2019-17, Final Award, 13 March 2023, para 715: 'As the Tribunal's analysis has made clear, Spain acted within the boundaries of the discretion which the EU and Spanish legal framework allowed. Irrespective of the fact that a mere violation of domestic law would not be sufficient to trigger international responsibility, the Claimants have been unable to point to instances in which Spain violated its own laws, let alone "eviscerated the fundamental principles" of the law.' (emphasis added).

[102] id, para 614: '[A]s a result of the discretion which the Bank of Spain enjoyed in granting or refusing ELA, a financial institution cannot expect that it will necessarily receive ELA, nor does it have an entitlement to ELA.'

[103] id, para 583: 'Regulation No. 236/2012 affords a wide margin of discretion to the competent authority, here the CNMV. In exercising their discretion, national authorities must either undertake a proportionality analysis in the presence of a serious threat to financial stability or market confidence (Article 20(1)(a)) or consider the appropriateness of a restriction or ban on short sales, if the share price drops significantly (Article 23(1)). The competent national authority is thus tasked with weighing the pros and cons linked to restricting short selling in a given situation, balancing the potential benefits of short selling with their possible "adverse effects"'.

[104] id, para 532.

[105] *Bank Melli v Bahrain*, PCA Case No 2017-25, Award, 9 November 2021, para 682.

The tribunal in *Antonio del Valle Ruiz* also considered factors beyond the regulatory framework, relying on a standard of 'appropriate regulatory practice'.[106] However, the Claimant did not refer 'to any document, precedent, or authority to support a finding that monitoring the withdrawals, or directing their suspension, would have been the "expected" regulatory practice in the circumstances.'[107]

In any case, a supervisor must not treat a certain actor in a discriminatory manner without justification. In that vein, the tribunal in *Saluka v Czech Republic* found that 'by providing state financial assistance to three of the Big Four banks to the exclusion of [the fourth]' as a response to a debt problem in its banking sector, the respondent (Czech Republic) acted in a discriminatory manner.[108]

Relevance of Procedural Safeguards

Procedural safeguards can be found in the applicable legal framework but might even emanate from beyond: In *Alex Genin v Estonia*, the tribunal found that 'certain procedures followed by the Estonian authorities in the present instance, while they do conform to Estonian law and do not amount to a denial of due process, can be characterised as being contrary to generally accepted banking and regulatory practice.'[109] This included instances where no formal notice was given that the license would be revoked unless the bank complied with the supervisor's demands within a reasonable time, where the bank had no opportunity to respond to the charges brought by the supervisor or where the revocation of the license was made immediately effective, without an opportunity to challenge it in court.

Another procedural safeguard is the supervisor's need to maintain a record of the reasons for the measures taken. In *Bank Melli v Bahrain*, the tribunal noted that a lack of records 'stands in sharp contrast with the regulatory framework requirements'.[110] The requirement to maintain proper records thus is ancillary to the adherence to a thorough review.

The Supervisor's Communication Policies

Finally, a supervisor should act with the required prudence and confidentiality when communicating about a bank or handling certain situations.[111]

D. The emergency takeover of Credit Suisse

The main issue that arises from the emergency takeover of Credit Suisse by UBS for judicial review of supervisory decisions is the write-down of A1 bonds by FINMA on 19 March 2023. The outcome of litigation by AT1 bondholders against FINMA and the government is unclear. However, the effects of FINMA's move on the global AT1 bond market have already been felt.

There are (at least preliminary) lessons to be learned from the bank's takeover. From the resolution perspective, a bank can reach non-viability even if complying with regulatory capital and liquidity requirements. The crisis also highlighted the importance of resolution financing. Regarding regulation and supervision, it will be necessary to clarify what AT1 bonds are there for and how they will be handled in similar cases. Another lesson from the Credit Suisse failure is that close ('cosy') relationships between banks and supervisors remain a significant risk. Creating a 'Swiss megabank' by UBS' takeover of Credit Suisse leads to new challenges for the supervisor – now there is an even bigger bank,

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[106] *Antonio del Valle Ruiz v Spain*, PCA Case No 2019-17, Final Award, 13 March 2023, para 535.
[107] id.
[108] *Saluka v Czech Republic*, Partial Award, 17 March 2006, para 347.
[109] *Alex Genin v Estonia*, ICSID Case No ARB/99/2, Award, 25 June 2001, para 364. (emphasis added)
[110] *Bank Melli v Bahrain*, PCA Case No 2017-25, Award, 9 November 2021, para 662, which continues: 'In particular, pursuant to the CBB Rulebook, the procedure for placing a bank under administration should have been initiated by way of a proposal to this effect, which would then be subject to a "thorough review" by the CBB of all relevant facts, assessed against specific criteria. […] Had the CBB followed this rule, there would have been an extensive documentary record readily available at the CBB, which the Respondent would have been able to produce.'
[111] See, *eg*, *Antonio del Valle Ruiz v Spain*, PCA Case No 2019-17, Final Award, 13 March 2023, paras 547 and 685; *Saluka v Czech Republic*, Partial Award, 17 March 2006, para 481.

which could be too big to fail (or even too big to bail). Many uncertainties remain regarding the takeover, including legacy issues, political backlash, or talent drain.

VII. Developments in International and EU Banking Regulation during 2022-2023

A. International financial standards

(1) Notwithstanding the significance of the initiatives undertaken during this period by various international financial fora, including the Financial Stability Board (FSB), in the fields of sustainable finance, digital assets and central bank digital currencies (which are beyond the scope of this part of the Report, see above under III), there were no major developments in relation to international banking regulation. In particular, the related international financial standards included in the FSB's "Key Standards for Sound Financial Systems"[112] (the main component of its "Compendium of Standards and Codes") have not been amended. However, the "Core Principles for Effective Banking Supervision" of the Basel Committee on Banking Supervision (BCBS) (which are included in this Compendium and are in force as last time amended in September 2012[113]), are currently under review with a view to their updating and further enhancement. The relevant Consultative Document of July 2023[114] highlights the need to introduce amendments relating to several "thematic topics" reflecting regulatory and supervisory developments in financial risks, including new risks, such as climate-related financial risks and the digitalisation of finance; operational resilience; systemic risk and macroprudential aspects of supervision; non-bank financial intermediation (NBFI); and risk management practices.

(2) It is also noteworthy that, in October 2023, the BCBS and the FSB published two Reports relating to an overall assessment of the causes of the spring 2023 financial turmoil and the initial lessons learnt. Their focus though is different (due to the diverging objectives of these two international financial fora). The BCBS *Report on the 2023 banking turmoil*, of 5 October,[115] undertakes an assessment of the regulatory and supervisory responses to the failure episodes, clearly stating that the discussion therein is not an indication of planned revisions to the Basel Framework. On the other hand, the FSB Report of 10 October 2023, entitled *2023 Bank Failures: Preliminary lessons learnt for resolution*[116], remarks that the failures of the US banks proved that even banks which are not included in its list of "global systemically important banks (G-SIBs) can still be systemically significant or critical in failure. It further assesses the implications for its "Key Attributes of Effective Resolution Regimes for Financial Institutions" framework[117] in resolving G-SIBs and other systemically important banks and sets out considerations on the effective implementation (and in some jurisdictions operationalisation) of the international resolution framework that merit further attention as part of the future FSB work.

(3) Furthermore, on 14 December 2023, the International Association of Deposit Insurers (IADI) published a Report entitled *The 2023 banking turmoil and deposit insurance systems: Potential implications and emerging policy issues*.[118] As noted in its Executive Summary,[119] this Report

[112] At: https://www.fsb.org/work-of-the-fsb/about-the-compendium-of-standards/key_standards.
[113] At: https://www.financialstabilityboard.org/2012/09/cos_061030a.
[114] At: https://www.bis.org/bcbs/publ/d551.pdf.
[115] At: https://www.bis.org/bcbs/publ/d555.pdf.
[116] At: https://www.fsb.org/2023/10/2023-bank-failures-preliminary-lessons-learnt-for-resolution.
[117] At: https://www.Financialstabilityboard.org/2014/10/r_141015 (in force as last amended in 2014).
[118] At: https://www.iadi.org/en/assets/File/Papers/IADI_2023_Potential_implications_and_emerging_policy_issues_for_DI_.pdf.
[119] *Ibid*, pp. 5-6.

analyses, albeit in a descriptive way, the potential implications and emerging policy issues for deposit insurance systems resulting from the spring 2023 financial turmoil. It also identifies a number of issues and challenges, in four key areas, which should be further analysed and can inform the review, in 2024, of the "IADI Core Principles for Effective Deposit Insurance Systems" of 1 November 2014,[120] notably: deposit insurance design, bank failure resolution, financial safety-net coordination (including the strengthening of the IADI's engagement and cooperation with, *inter alia*, the BCBS and the FSB), as well as the implications of digital innovation.

B. EU Law

The EU regulatory framework governing prudential banking regulation and supervision, as well as the crisis management and deposit insurance (CMDI) framework has also not been amended during the period under review. There are, however, two key developments which need to be taken under consideration:

(1) The first relates to the final adoption by the European Parliament and the Council (hereinafter the "co-legislators") of the Commission's October 2021 "legislative banking package",[121] which contains three legislative proposals amending the single rulebook for banking services in the EU, namely the co-legislators Capital Requirements Regulation (CRR) and the Capital Requirements Directive No IV (CRD IV),[122] as well as (to a lesser extent) the Bank Recovery and Resolution Directive (BRRD).[123] It forms part of the regular review of that EU banking legislation, which started in 2016 with the "Risk Reduction Measures Package" that was adopted in 2019. The aim of the proposed rules is to ensure that EU credit institutions become more resilient to potential future economic shocks, while contributing to the EU's recovery from the pandemic crisis and the transition to climate neutrality. The key pillars of this package, the first three of which are expected to be adopted by the co-legislators in early 2024, are the following:

The *first pillar* refers to the implementation into EU law of the Basel Committee's 2017 Report "Basel III: Finalising post-crisis reforms", considering the specific features of the EU banking system. This aims to ensure that "internal models" used by credit institutions to calculate their capital requirements do not underestimate risks, thereby ensuring that the capital required to cover those risks is sufficient, without resulting in significant increases in capital requirements. Compliance costs, in particular for smaller banks, are also further reduced without compromising prudential standards.

The *second pillar*, on sustainability – contributing to the green transition, aims to strengthen the resilience of the banking system to environmental, social and governance (ESG) risks as part of the Commission's Sustainable Finance Strategy, as set out in its Communication of 6 July 2021,[124] which identifies four main areas (policy objectives, pillars) where additional actions are needed for the financial system to fully support the transition of the economy towards sustainability. Under the proposed rules, credit institutions will be required to systematically identify, disclose, and manage ESG risks as part of their risk management. Supervisory authorities will have to conduct regular

[120] At: https://www.financialstabilityboard.org/2014/11/cos_090618.
[121] At: https://ec.europa.eu/info/consultations/finance-2021-esas-review_en.
[122] Regulation (EU) No 575/2013 of 26 June 2013 "on prudential requirements for credit institutions (…)" and Directive 2013/36/EU of the same date "on access to the activity of credit institutions and the prudential supervision of credit institutions (...)", OJ L 176, 27.6.2013, pp. 1-337 and 338-436, respectively (both as in force).
[123] Directive 2014/59/EU of 15 May 2014 "establishing a framework for the recovery and resolution of credit institutions and investment firms (...)", OJ L 173, 12.6.2014, pp. 190-348, as in force.
[124] COM/2021/390 final.

climate stress testing and assess ESG risks as part of the SREP, while credit institutions will have to disclose the degree to which they are exposed to ESG risks.[125]

The objective of the *third pillar* is to strengthen prudential banking supervision to ensure sound management of EU credit institutions and better protect financial stability. In this respect and *inter alia*, the package: *first*, sets out stronger tools for supervisory authorities, by establishing a clear, robust and balanced "fit-and-proper" set of rules to assess whether senior staff have the requisite skills and knowledge for managing a credit institutions; *second*, equips supervisory authorities with better tools to oversee fintech groups, including credit institutions' subsidiaries; and *third*, addresses, in a proportionate manner, the issue relating to the establishment of branches of third-country credit institutions established in the EU by harmonising the related EU rules, which will allow supervisory authorities to better manage the risk exposure of these entities (that have significantly increased their activity in the EU over recent years).

Finally, some technical modifications to the banking resolution framework in the CRR and the BRRD were proposed, aimed at clarifying certain aspects regarding the prudential treatment of global systemically important institution (G-SII[126]) groups with a multiple-point-of-entry (MPE) resolution strategy *and* methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities (MREL), the so-called "daisy chain" proposal. This is the only element of the package that has been finalised by the adoption by the co-legislators on 19 October 2022 of Regulation (EU) 2022/2036.[127]

(2) On the basis of its targeted consultation document of 26 January 2021 on the "Review of the [CMDI] framework"[128] and the responses thereto, the Commission submitted, on 18 April 2023, a legislative package proposing the amendment of the BBRD and the co-legislators' Single Resolution Mechanism Regulation (SRMR)[129] "as regards early intervention measures, conditions for resolution and funding of resolution action", and the amendment of the co-legislators' Deposit Guarantee Schemes Directive (DGSD) of the co-legislators of 16 April 2014[130] (DGSD), "as regards the scope of deposit protection, use of deposit guarantee schemes funds, cross-border cooperation, and transparency".[131] Thus, it formally initiated the process for the review of the CMDI framework.

In accordance with its related Communication of the same date,[132] which concludes by inviting the European Parliament and the Member States to reach agreement on the proposed reform of the CMDI framework before the next elections of the European Parliament in 2024:

> "*The objective of the reform is to enhance the existing arrangements for managing failing banks in the EU. In particular, it is proposed to make the arrangements for managing the failure of smaller and medium-sized banks more effective in terms of their design and implementation. While the reform of the CMDI framework has been under discussion for several years and pre-*

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[125] This is heavily influenced by the EBA Report of 26 June 2021 "On management and supervision of ESG risks for credit institutions and investment firms" (EBA/REP/2021/18, available at: https://www.eba.europa.eu/eba-publishes-its-report-management-and-supervision-esg-risks-credit-institutions-and-investment).

[126] Global systemically important institutions (G-SIIs) are defined in point (133) of Article 4(1) CRR, as those that have been identified in accordance with Article 131(1) and (2) CRD IV.

[127] OJ L 275, 25.10.2022, pp. 1-10.

[128] At: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/2021-crisis-management-deposit-insurance-review-targeted-consultation-document_en.pdf.

[129] Regulation (EU) No 806/2014 of 15 July 2014 "establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (...)", OJ L 225, 30.7.2014, pp. 1-90, as in force.

[130] Directive 2014/49/EU of 16 April 2014 "on deposit guarantee schemes", OJ L 173, 12.6.2014, pp. 149-178; this is the only legislative act among those discussed herein that has not (yet) been amended.

[131] COM/2023/227 final, COM/2023/226 final and COM/2023/228, respectively. It is noted, however, that the proposed amendments cover a wider field of aspects that those referred to in the title of the legislative proposals.

[132] COM/2023/225 final.

dates the very recent U.S. and Swiss banking crises,[133] *these underline the importance of ensuring that EU arrangements for managing bank failures are as robust and effective as possible.*"

In accordance with this Communication, a review of the Commission's banking State aid framework is underway and is expected to be completed in early-2024, which, given the interlinkages between the CMDI and the State aid frameworks, aims at ensuring the necessary consistency and could lead to a solid assessment as to whether a more progressive approach should be adopted with different criteria for assessing the compatibility of State aid in the form of preventive measures, resolution measures or liquidation aid in insolvency.

(3) It is finally noteworthy that both these packages do not address issues relating to the -in the author's (and not only) view – 'unfinished' agenda for the completion of the EU single market in financial services and of the Banking Union. These include the introduction of sovereign bond-backed securities, the creation of a European Deposit Insurance Scheme (EDIS) and a European Deposit Insurance Fund (EDIF), the harmonisation of EU rules on the winding-up of credit institutions, and the provision of emergency liquidity assistance (ELA) to credit institutions exposed to illiquidity directly by the ECB.

[133] In relation to the state-backed emergency rescue of the *Credit Suisse* by *UBS*, see the joint Statement of the SRB, the EBA and the ECB/SSM of 20 March (at: https://www.eba.europa.eu/srb-eba-and-ecb-banking-supervision-statement-announcement-19-march-2023-swiss-authorities).