European University Institute

DEPARTMENT OF LAW

Supervisory Convergence on the EU Capital Markets Union:

A new incentive for strengthening the supervisory architecture

Jens Marlon van Straalen

Thesis submitted for assessment with a view to obtaining the degree of Master in Comparative, European and International Laws (LL.M.) of the European University Institute

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Researcher declaration to accompany the submission of written work
Department of Law – LL.M. Programme

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This thesis has not been corrected for linguistic and stylistic errors.

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Contents:

List of abbreviations:

AIFM	-	Alternative Investment Funds Managers
Brexit	-	Exit of Great Britain from the European Union
BTS	-	Binding Technical Standards
CCM	-	Classic Community Method
CCP	-	Central Counter Party
CEBS	-	Committee of European Banking Supervisors
CEIOPS	-	Committee of European Insurance and Occupational Pensions Supervisors
CESR	-	Committee of European Securities Regulators
CJEU	-	Court of Justice of the European Union
CMU	-	Capital Markets Union
CRA	-	Credit Rating Agency
CRD IV	-	Capital Requirements Directive IV
CRR	-	Capital Requirements Regulation
CSD	-	Central Securities Depository
EBA	-	European Banking Authority
ECB	-	European Central Bank
EIOPA	-	European Insurance Occupational Pensions Authority
EMIR	-	European Markets Infrastructure Regulation
EMU	-	European Monetary Union
ESA	-	European Supervisory Authority
ESC	-	European Securities Committee
ESRB	-	European Systemic Risk Board
ECSC	-	European Coal and Steel Community
ESFS	-	European System of Financial Supervision
ESMA	-	European Securities and Markets Authority
ESRB	-	European Systemic Risk Board
EU	-	European Union
FSAP	-	Financial Services Action Plan
FSB	-	Financial Stability Board
IFRS	-	International Financial Reporting Standards
IOSCO	-	International Organization of Securities Commissions
ITS	-	Implementing Technical Standards
MiFID	-	Markets in Financial Instruments Directive

MiFIR	-	Markets in Financial Instruments Regulation
NCA	-	National Competent Authority
OTC	-	Over the Counter
RTS	-	Regulatory Technical Standards
SSM	-	Single Supervisory Mechanism
STS	-	Simple, Transparent and Standardised
SSPE	-	Securitisation Special Purpose Entity
TEU	-	Treaty on the European Union
TFEU	-	Treaty on the Functioning of the European Union
UCITS	-	Undertakings for Collective Investment Securities
UK	-	United Kingdom

"At the summit you will find yourselves united with all those who, from every direction, have made the same ascent. For everything that rises must converge."

- Pierre Teilhard de Chardin, Omega Point

"Let this go as it is, without any summary"
- Yevgeny Zamyatin, We

1. Introduction

1.1 The Capital Markets Union and Supervisory Convergence

It is no secret that the financial crisis of 2008 has had a great impact on the regulatory landscape in the European Union ('EU' or 'Union'). As a result of the deep economic impact the financial crisis, the EU has set out over the past years to pass a wide scale of regulatory reform in the financial sector that was meant to close loopholes in legislation and address weaknesses in the financial systems.[1] More recently however a shift in emphasis has taken place to not only restore investor confidence through regulatory repair of the legislative framework, but also to make the financial system more resilient, and focus on economic growth.[2]

An important step in this process is the creation of a Capital Markets Union ('CMU') for the EU. Jean-Claude Juncker, the President of the European Commission ('Commission'), introduced this project as an important policy in his agenda of political guidelines for his Commission.[3] This project would introduce a true and genuine single market for capital across all 28 Member States.[4] In September 2015, the Commission set out a wide range of legislative objectives in order to establish the CMU.[5] In building the CMU, the Commission revises existing legislation in order to harmonize standards, or introduces new legislative proposals. More recently, in June 2017 the Commission evaluated the CMU project in its Mid-Term Review, and underlined the necessity of the CMU project once more, as well as its intention to continue and advance its CMU policy and law making.[6]

The CMU sees to a large extent to integrating the capital markets of Member States through legislation, but this must be accompanied by adequate standards of supervision. This is crucial

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[1] B. Stellinga, 'Europese Regelgeving voor en na de crisis', *WRR Working Paper* 2015, No. 15. Pp. 65-67. See also: E. Ferran e.a. (eds.), *The Regulatory Aftermath of the Global Financial Crisis*, Cambridge: Cambridge University Press 2012.
[2] ESMA, *ESMA Strategic Orientation 2016-2020*, ESMA/2015/935, 2015a. Pp. 4-5.
[3] J.C. Juncker, 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change', *Political Guidelines for the next European Commission,* (22 October 2014), 2014. P. 7.
[4] Commission, *Green Paper: Building a Capital Markets Union* (Communication), COM(2015) 63 final, 2015a. P. 2.
[5] Commission, *Action Plan on Building a Capital Markets Union* (Communication), COM(2015) 468 final, 2015b.
[6] Commission, *On the Mid-Term Review of the Capital Markets Union Action Plan* (Communication), COM(2017) 292 final, 2017a. Pp. 8-10.

because substantial differences in the application of these frameworks may still arise, even though regimes of financial regulation can be harmonized. This is for three main reasons. Firstly, there are differences in local economies in terms of scale, market structures and business practices, leading to different supervisory practices. Secondly, national competent supervisory authorities ('NCAs') have different resources available to them also relative to market size and their structure. Lastly, strong differences exist in regulatory and supervisory philosophies, objectives and techniques of supervisory authorities.[7] The same or similar rules are therefore not enough to have the same comparable outcomes on financial markets.[8] Standards of supervision must therefore be encouraged to converge as well in order to achieve the same application of the rules brought forward by the CMU project. In the EU, recently the focus has shifted towards ensuring that all the rules following from the harmonized legislative framework are actually implemented and applied by all Member States.[9] This process of supervisory convergence is defined as "the same application and implementation of the same rules using similar approaches."[10] The question then rises on how such supervisory convergence can be best achieved, and what sort of institutional framework is required to accomplish it.

1.2 Research Question and Structure

This thesis examines therefore how the CMU framework aims to achieve supervisory convergence on the EU capital markets. It shall have particular regard as to how the CMU might seek to promote supervisory convergence through reform of the institutional framework, and what the impact of the CMU project is on the current supervisory framework. Hence, the research question of this thesis will be the following:

"*How does the Capital Markets Union project promote supervisory convergence on the European capital markets and how does the pursuit of supervisory convergence through the Capital Markets Union impact the supervisory framework on European capital markets?"*

The thesis shall commence by discussing the concept of capital markets in chapter 2, in order to establish the scope of the area that falls within the objectives of the CMU, and what capital market integration under this project can achieve. Under chapter 3, financial governance in the EU will be discussed. This provides an opportunity to characterize the wider developments in EU

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[7] S. Maijoor, *'Priorities of a Capital Markets Union'*, Speech at the Luxembourg Stock Exchange Day, ESMA/2015/854, 22 May 2015. P. 7.
[8] D. Busch, *A Capital Markets Union for a Divided Europe* (December 31, 2016), 2016. Available at SSRN: https://ssrn.com/abstract=2899749. P. 8.
[9] ESMA, *Work Programme 2017*, ESMA/2016/1419, 2016a. P. 4.
[10] ESMA, *Supervisory Convergence: Work Programme 2016*, ESMA/2016203, 2016b. P. 3.

governance, and demonstrate how this has had an effect on supervisory governance in the financial sector. Additionally it provides an introduction to the diverse methods of decision-making, which are applicable to supervisory frameworks. Chapter 4 shall build on these forms of financial governance by discussing the concept of supervisory convergence and what institutional frameworks can be used to achieve this. I present two distinctly characteristic models that can be used to achieve supervisory convergence: a centralized model of supervision, or a network based model of supervisory convergence. I shall assess the advantages and limitations of each of these models. Chapter 5 shall then analyze the current institutional framework of European supervision in capital markets in particular. Especially the role of the European Securities and Markets Authority ('ESMA') shall be discussed, as it is one of the most important actors in promoting supervisory convergence on the EU capital markets. Chapter 6 shall assess how the CMU brings about a reform in the current regime of supervisory convergence and what the constitutional limitations are to institutional reform. Chapter 7 provides an analysis of smaller institutional developments regarding supervisory convergence that are not presented as 'institutional reform' by the Commission, but follow from secondary legislation and provide for smaller, incremental changes. This will be done by assessing three legislative documents that have been presented as important introductions under the CMU framework. Afterwards, the last chapter (Chapter 8) shall provide for a conclusion to the project as a whole.

In terms of methodology the thesis will make use of a doctrinal approach in its research. It focuses on discussing and analysing the relevant EU law, case law and literature. The thesis engages in an extensive literature review to describe the development of capital market integration, financial governance in the EU, the different models of supervisory convergence in chapters 2-4. In the fifth chapter, I shall analyze the institutional framework governing financial supervision on EU capital markets in order to place the supervisory regime into the outlined discussions in the previous chapters. In chapter 6 a thorough legal examination will be made of the constitutional framework, as well as the relevant policy documents regarding the CMU, in order to establish how the supervisory convergence framework could be altered under this policy project. In the seventh chapter I shall engage in an analysis of the three most important CMU related pieces of legislation: the Prospectus Regulation, the final negotiated version of the new Securities Regulation and two proposal to amend EMIR.

This research focuses on a moving target due to the novelty of the CMU project and the continuous revelation of new legislation or policy documents that alter previous regulation. Hence, the legal analysis in the last two chapters is largely supported by primary sources, seeing as at the time of writing a gap in the literature currently exists as to the newer legislation.

'You veer through the market, and if you're not dizzy enough from all that stuff, wood stalls full of bananas and mangoes and ackee and grapefruit and frill dresses and gabardine cloth for pants – blink and you'll miss it'

– Marlon James, *A brief history of seven killings*

2. Capital Markets: towards a European Capital Markets Union

This chapter is divided into three parts. The first part discusses the concept of capital markets. It shall provide a definition, and discuss the functions and benefits of capital markets (section 2.1). The second part shall discuss the process of capital market integration, including the methods of integration, but also the risks attached to these methods (section 2.2). Lastly, this chapter discusses the CMU project. It shall briefly explain the process of capital market integration in the EU, and why CMU must be seen as an important new incentive to accomplish EU capital market integration. It shall conclude by assessing what progress has been made regarding the CMU project and how it has developed (section 2.3).

2.1 Capital Markets

A capital market is a financial market where capital flows from individuals that are seeking to invest to those in search of investments. This happens through the issuing and trading of securities to raise medium- and long-term finance.[11] A capital market is not a physical place, but refers to the available capital from financial institutions and investors (such as pension funds or hedge funds) that are prepared to purchase securities.[12] These can be equity securities, in the form of shares, or debt securities such as bonds. References to the size of the market entail the overall funds' quantity from the participants, and the tradability of the securities on the market.

There are different ways to discern between types of capital markets. One can distinguish between primary markets where new securities are issued, and secondary markets where individuals trade in already issued securities. These secondary markets can take the form of organised exchanges, such as stock exchanges, or can be dealt with in an *over the counter* ('OTC') market, where dealers and buyers sell and buy securities directly from each other.[13] A different way of distinguishing between types of capital markets is through the trading mechanism that is used by the market in question. The two types of trading mechanisms used are

[11] L. Burn & E. Greene, 'What are capital markets and what are they for?', *Capital Markets Law Journal* 2016, Vol. 11, No. 3, pp. 340-351. P.340.
[12] D. Adams, *Banking and Capital Markets,* Guildford: College of Law Publishing 2011. P. 208.
[13] J. De Haan, S. Oosterloo & D. Schoenmaker, *Financial Markets and Institutions: A European Perspective,* Cambridge: Cambridge University Press 2015. P. 160.

quote-driven markets or order-driven markets. In quote-driven markets, the traders offer quotes with bid and ask prices of up to specific volumes. In an order-driven market on the on the other hand, the trading mechanism requires participants to buy or sell at the hand of orders they have issued to buy or sell at a certain price. Instructions are then given to buy or sell at that specific price as soon as a certain security reaches that price, and this actual price is publicly verifiable.[14] Additionally, it is possible to distinguish between types of capital markets on the basis of the financial instruments traded on that market. A straightforward example would be the bond market, which constitutes a capital market on which solely bonds are sold. More complex capital markets are markets regarding financial instruments such as the '*cfd-market'*, where contracts for differences are sold.

2.1.1 Functions of capital markets

Capital markets allow individuals who have a surplus of funds to buy securities from market participants who are short of money and hence sell or issue new securities.[15] In this way capital markets fulfil a crucial role in the financial system by connecting investors with those who need investment.[16]

Bailey distinguishes three additional crucial functions of capital markets.[17] Firstly, capital markets distribute information in the pre-trading phase. The participant in a capital market can perceive what the prices of certain securities are, as a central platform in the capital market disseminates information about the prices that parties are prepared to buy or sell securities at. This distribution of information allows the price formation process to take place. This in turn strengthens investor confidence, as uncertainty and arbitrary price offerings are removed from the market.[18] Secondly, the capital market provides the trading mechanism in itself during the trading. The market constitutes the main infrastructure that enables trading to take place, and hence provides an instrumental function. Thirdly, the capital market provides a guarantee. Through the capital markets as a guarantor, the parties are ensured that the terms of the agreement will be fulfilled. Which often entails that the capital market fulfils a regulatory function governing the trades that are made on it. This can happen by additional standard setting and authorisation of the parties admitted to trading on capital markets.[19]

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[14] De Haan, Oosterloo & Schoenmaker 2015. P. 159.
[15] De Haan, Oosterloo & Schoenmaker 2015. P. 157.
[16] A. Fleckner, 'Regulating Trading Practices', in: N. Moloney, E. Ferran & J. Payne (eds.), *Handbook of Financial Regulation*, Oxford: Oxford University Press 2015. P. 599.
[17] R. Bailey, *The Economics of Financial Markets*, Cambridge: Cambridge University Press 2005. P. 34.
[18] Fleckner 2015. P. 600.
[19] A. Fleckner & K. Hopt, 'Stock Exchange Law: Concept, History, Challenges', *Virginia Law & Business Review* 2013, Vol. 7, No. 3, pp. 513-542. Pp. 516-517.

Two other functions are recurrently discussed in the literature. Such an additional fourth function is that capital markets allow the spreading of risk.[20] Seeing as securities can be sold on through capital markets to third parties, this allows the risk of an investment to be passed on and spread over different investors. Lastly, capital markets have become focused on operating on profit-making basis, hence fulfilling a profit making function.[21]

2.1.2 Benefits of capital markets

As mentioned above, capital markets play an important connecting role for investors. This importance is predominantly due to the fact that it channels money through the economy. By allowing companies to raise capital, it ensures that innovation can take place, and funds can be (re)located efficiently. The fact that not only new securities can be issued, but also already existing securities can be traded is crucial to establishing this benefit. This is particular the case for the raising of short term capital for long term projects. In long-term investment projects, the holder of securities such as shares or bonds, can become in need of liquidity. Instead of having to withdraw his provided capital from a company, or being hesitant with future investments, he can sell the security on to a third investor. Capital markets hence, ensure that the exchanges between investors and parties seeking finance can remain liquid. At the same time the participant on a capital market that is looking to raise capital is provided with access to a wide diversity of funding options, most suitable to their needs. Hence capital markets are crucial to overall market efficiency in any liberal economy, and in this way capital markets contribute to, and foster economic growth.

2.2 Capital Market Integration

2.2.1 Why Integration of Capital Markets?

For a capital market to fulfil its functions and maximize benefits as listed under 2.1 the degree of international integration is considered by some to be of great importance. Capital markets are fully integrated when financial assets on that market have the same risk profile and price, even if it is traded on a different market in a different country.[22] In such cases, country specific risk still occurs but only common risk factors are priced, because the country specific risk is diversifiable. In this manner the price of the financial asset will be the same across the capital markets. In fragmented and non-integrated capital markets, market participants face only country-specific

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[20] C. Allard e.a., 'Towards a Fiscal Union for the Euro-Area', *IMF Working Paper* 2013, SDN/13/09. Available at: https://www.imf.org/external/pubs/ft/sdn/2013/sdn1309.pdf. N. Verón & G.B. Wolff, 'Capital Markets Union: a Vision for the Long Term', *Journal of Financial Regulation* 2016, Vol. 2, No. 2, pp. 130-153. P. 137.
[21] Fleckner & Hopt 2013. P. 517.
[22] M. Emris, 'Measuring Capital Market Integration', *BIS Papers* 2002. No. 12. P. 200.

risk factors, which leads to different pricing on different capital markets for the same financial instrument. This will lead to varying returns on the assets, due to diverging risk profiles.[23]

The integration of capital markets across regions additionally provides wider access to participants, leading to a greater size of capital markets. Such an integrated capital market lowers the costs for participants.[24] This is because as more investors enter the market, increased competition provides an important incentive for reducing the operating cost of intermediaries.[25] This has as an additional result that as capital markets integrate, returns increase.[26]

Another strong argument for integration of capital markets is the spreading of risk, as briefly mentioned above as a benefit of capital markets. Having a multitude of investors from across different regions allows for risk reduction. If a company were to become insolvent, this could mean that it would not be able to pay his contractual obligations under issued securities. If all investors came from a specific region or country, this could have a negative effect on the local economy, and even pull other institutions down into a spiral. If investors are however spread across geographical regions the impact of such risk being realized can be more limited.[27]

2.2.2 Methods of Capital Market integration and their risks

There are two ways of achieving market integration. The first method is negative integration, which constitutes a prohibition on any barriers between capital movements. This amounts to a form of liberalization as regulatory barriers will have to be struck down or cannot be imposed. The second method is through positive integrations where regulatory standards are harmonized between different regimes of capital markets regulation.[28] In order to integrate capital markets both methods are crucial in a twofold process, consisting out of liberalizing capital transactions and harmonizing market infrastructure.[29] National regulations for cross-border capital transactions prevent foreign investors to enter national markets, and form obstacles to integrated capital markets. Liberalization abolishes or prohibits such regulatory barriers, whereas harmonization ensures similar regulatory frameworks governing trading systems and market

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[23] Price Waterhouse Coopers (PWC), *Capital Markets Union: Integration of Capital Markets in the European Union*, Report, 2015. Available at: https://www.pwc.com/gx/en/banking-capital-markets/pdf/cmu-report-sept-2015.pdf. P. 8. Emris 2002. P. 200.
[24] W. Seifert e.a., *European Capital Markets,* London: MacMillan Press 2000. P. 74.
[25] PWC 2015. P. 10.
[26] Seifert e.a. 2000. P. 74.
[27] ECB, Building a Capital Markets Union— Eurosystem Contribution to the European Commission's Green Paper, 2015. Pp. 2-3. J. Vinals, '*Global Perspectives on Capital Market Integration'*, Speech at the ECB, 2 July 2015. Available at: http://www.imf.org/en/News/Articles/2015/09/28/04/53/sp070215.
[28] C. Barnard, *The Substantive Law of the European Union: The Four Freedoms*, Oxford: Oxford University Press 2015. PP. 195-196.
[29] M. Yabara, 'Capital Market Integration: Progress Ahead of the East African Community Monetary Union', *IMF Working Paper* 2012. No. 18. P. 8.

infrastructure, which is essential in obtaining the same price for the same financial assets across capital markets.[30]

This does not mean however that integration is without controversy. Integration of capital markets can generate new risks and volatility. Particularly liberalization of capital markets is criticized as it can involve the striking down of legislation or other regulatory measures. Consequently, such liberalization can lead to a loss of control over markets for governments or public authorities.[31] In the absence of this enforceable regulation, market participants face the risk that credit can be withdrawn by lenders, or borrowers default on their obligations.[32] Furthermore, Stiglitz argues that the liberalization of capital markets contributes to instability due to the fact that capital markets operate differently from ordinary markets. Due to their role in the dissemination of information, liberalization can have very negative effects. This can be seen in the fact that imperfect information on the capital market is almost never, or rarely, constrained.[33]

Additionally, substantial capital transactions between different currencies can cause volatility in exchange rates, leading to different price swings. This in turn can change relative prices without taking movements in relative costs in account.[34] In that regard it is also relevant that capital market flows are pro-cyclical, and move in the same direction as the overall economy, but can also have a magnifying effect on the overall economic system.[35] Hence when investors receive new information on a risk profile this can lead to sudden outflows of capital, and undermine the economic system as a whole.

As integration of capital markets is expected to contribute to bringing in a wider range of investors and bigger investors, there is an additional risk of some of these parties becoming more and more systemically relevant. This is already the case to a certain extent in the current European capital markets.[36] Hence, it is important that the process of integration is supported by an accompanying level of financial supervision.[37]

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[30] Ibid. P. 8
[31] J. Pierre (ed.), *Debating Governance. Authority, Steering, and Democracy,* Oxford: Oxford University Press 2000. P. 1.
[32] E. Jones, 'Liberalized capital markets, state autonomy, and European Monetary Union', *European Journal of Political Research* 2003, Vol. 42, No. 2, pp. 197–222. Pp. 211-212.
[33] J. E. Stiglitz, 'Capital Market Liberalization, Economic Growth, and Instability', *World Development* 2000, Vol. 28, No. 6, pp. 1075-1086. P. 1079.
[34] Jones 2003. P. 212.
[35] Stiglitz 2000. P. 1079.
[36] ESRB, *EU Shadow Banking Monitor*, No. 2, May 2017. P. 2.
[37] ECB, *ECB contribution to the European Commission's consultation on Capital Markets Union mid-term review 2017*, 2017a. P. 3.

2.3 Capital Market integration in the EU: towards the CMU

In the following section, an overview of capital markets integration in the EU shall be provided. It shall firstly outline what the EU has done in previous attempts of capital market integration. Secondly, the objectives of the CMU will be discussed. The section concludes with an overview of the progress the CMU agenda has made in achieving its objectives.

2.3.1 Earlier attempts at integration

The earliest European attempt at financial market integration stemmed from 1966, when the Segre Report made some strong recommendations as to how to guarantee the free movement of capital across borders, in particular regarding securities.[38] Due to a lack of powers and political will the European Community was not able to follow up adequately on these recommendations. This resulted in the situation where at the end of the twentieth century, financial markets remained fragmented with only a few directives providing for very minimum standards of harmonisation. Even then, the implementation of the little regulation present diverged greatly, and relied too much on the principle of mutual recognition, which was considered ineffective.[39] Under this framework, broad justifications of general interest by Member States prevented access to different capital markets for investors.[40]

Financial integration was put on the agenda once more to secure a smooth transition and facilitate the establishment of the European Monetary Union ('EMU') after its introduction under Treaty of Maastricht.[41] This resulted in the introduction of the Financial Services Action Plan ('FSAP') in 1999 by the Commission.[42] In 2001 however, a new report by a Group of financial experts ('the Lamfalussy Report') proposed a new legislative structure for the integration of financial markets in order to accelerate the measures of the FSAP. This legislative framework, also named the 'Lamfalussy procedure', constituted four different levels of regulation, on both a legislative and regulatory level. On the first level, the ordinary legislative procedure applied. The Commission proposed topics that had to be harmonised, and the Council and the European Parliament would

[38] C. Segré e.a., '*The development of a European capital market. Report of a Group of Experts appointed by the EEC Commission*' (Report), 1966. Available at: http://aei.pitt.edu/31823/1/Dev_Eur_Cap_Mkt_1966.pdf.

[39] P. Nelson, *Capital Markets Law and Compliance: The implications of MiFID*, Cambridge: Cambridge University Press 2008. Pp. 53-55.

[40] Articles 17 & 18 Investment Services Directive. For an extensive discussion see: D. Busch, MiFID II/MiFIR: nieuwe regels voor beleggingsondernemingen en financiële markten Preadvies voor de Vereniging voor Financieel Recht 2015, Deventer: Wolters Kluwer 2015. P. 2.

[41] E. Avgouleas, 'The Harmonization of Rules of Conduct in EU Financial Markets: Economic Analysis, Subsidiarity and Investor Protection', *European Law Journal* 2000, Vol. 6, No. 1, pp. 72- 92. P. 73. Barnard 2015. P. 13.

[42] T. M. J. Möllers, 'European Legislative Practice 2.0: Dynamic Harmonization of Capital Markets Law – MiFID II and PRIIP', *Banking & Finance Law Review* 2015, Vol. 3, No. 1, pp. 141-176. Pp. 142-143.

then amend and pass the final versions of directives or regulations.[43] On the second level, the Commission would draft technical implementing measures after consulting the European Securities Committee ('ESC') and the Committee of European Securities Regulators ('CESR'). On the third level the CESR would adopt recommendations or guidelines for a common interpretation of the technical measures. These would function as implementing guidelines for the Member States.[44] This is why the CESR was also referred to as a 'Level 3 Committee'. Lastly, on the fourth level the Commission was responsible for supervising the right and timely transposition of the levels of legislation into national law, whilst relying predominantly on coordination and co-operation between Member States. The advantage of this procedure was that the delegation allowed for a more timely and efficient way of creating legislation, and incorporated highly technical advice by expert institutions.[45] Lower implementing regulations or technical standards no longer had to be passed through all relevant institutions, but could be rolled out more efficiently. The ESC and CESR played an important role under this framework, through which they were also able to incorporate and organize extensive consultations with market participants. The downside of the framework was that a large proportion of the lower level legislation was not always implemented or followed up on by Member States. Even the primary legislation was not always effective, as the majority of the legislation adopted under this framework constituted minimum standards of harmonization in the form of directives.[46] These often included optional provisions or led to gold plating practices.[47] Hence, enforcement often failed to be effective or consistent amongst Member States. These flaws led to the deficient regulatory framework, which in turn contributed to the severity of the financial crisis.[48]

The De Larosière Report of 2009 reviewed these failing aspects of the strenuous Lamfalussy process. First of all, it proposed the transformation of the existing level three committees, such as the CESR, into stronger European supervisory authorities ('ESAs') in order to create a European System of Financial Supervision ('ESFS'). Due to its constrained mandate and limited competences, the financial crisis clearly uncovered the shortcomings of the CESR to identify '*problems of competences in supervisory oversight, challenge supervisory practices, and [...]*

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[43] C. M. Grundmann-van de Krol, 'Europese invloed: de MiFID' in: D. Busch & C.M. Grundmann-van de Krol (eds.), *Handboek Beleggingsondernemingen. Serie Onderneming en Recht: deel 51*, Deventer: Kluwer 2009, pp. 27-152. P. 27

[44] Grundmann-van de Krol 2009. Pp. 33-34.

[45] Payne & Howell 2016. P. 9.

[46] Directives adopted under this framework included: Directive 2003/6/EC on insider dealing and market manipulation ('Market Abuse Directive'), the Market in Financial Instruments Directive, Directive 2004/25/EC on takeover bids ('Takeover Directive'); Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market ('Transparency Directive').

[47] J. De Larosière, *The High Level on Supervision in the EU Report* (Report), 2009. Available at: http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf. P. 75.

[48] De Larosière 2009. P. 27.

resulting [in a] lack of coordination in supervising cross border groups, so that significant risks created by home supervisors were born by host countries.'[49] The three European committees of financial supervisors were endowed as the ESAs with stronger regulatory powers in order to promote further harmonisation,[50] and therefore integration.

Under the new ESA format the CESR was converted into ESMA. Also outside of capital markets, the two other Level 3 Committees were transformed: the Committee of European Banking Supervisors ('CEBS') into a European Banking Authority ('EBA'), and Committee of European Insurance and Occupational Pensions Supervisors ('CEIOPS') into the European Insurance and Occupational Pensions Authority ('EIOPA'). The ESAs were equipped with far-reaching soft law powers in the form of "*quasi-rule-making powers, a range of supervisory powers which extend across a spectrum from convergence activities to (limited) supervisory powers over market actors, and extensive information- gathering powers*."[51] Under this system national supervisors remained in charge of the day-to-day supervision, but the ESAs would set supervisory standards and be in charge of the application of these standards by guaranteeing strong cooperation between the national supervisors. The powers of ESMA will be assessed separately in greater detail under Chapter 5, concerning the supervision of capital markets.

Additionally, the De Larosière Report argued strongly for providing the EU with a consistent set of rules.[52] In particular such uniform rules across the Union would need a strong shift to more maximum harmonization in order to ensure that loopholes and gaps in regulatory regimes were finally closed. The creation of the new ESAs provided an opportunity to address the regulatory shortcomings of the Lamfalussy legislative process. Now on the second level the Commission creates delegated legislation, but at the same time ESMA, CESR's successor, has the power to create draft regulatory technical standards ('RTS') or implementing technical standards ('ITS') that the Commission can then adopt.[53] On the third level the ESAs can issue non-binding guidelines and recommendations. These need to be complied with, or else market participants need to explain why they did not.

This framework allowed the introduction of the ambitious Single Rulebook project. This

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[49] B. Haar, 'Organizing regional systems: The EU example', in: E. Ferran, N. Moloney, N. Payne (eds.), *Oxford handbook on financial regulation,* Oxford: Oxford University Press 2015. Pp. 158–183. P. 173.
[50] De Larosière 2009. P. 50. E. Ferran, 'Understanding the New Institutional Architecture of EU Financial Market Supervision', in: E. Wymeersch, K.J. Hopt, G. Ferrarini (eds.), *Financial Regulation and Supervision: A Post-Crisis Analysis*, Oxford: Oxford University Press 2012. Pp. 116-130.
[51] N. Moloney. 'The European Securities and Markets Authority and institutional design for the EU financial market - a tale of two competences: part (1) rule-making', *European Business Organization Law Review* 2011a, Vol. 11, No. 1, pp. 41-86. P. 43.
[52] De Larosière 2009. Pp. 27-29.
[53] Möllers 2015. P. 143.

constituted a comprehensive set of common standards for financial institutions in order to restore a legal framework consistent with these ultimate goals.[54] This project gave rise to a new wave of capital market integration, where the shift towards maximum harmonization has been visibly present in the integration process. The dominant doctrine has been to push forward regulations rather than directives, and prevent discrepancies in implementation.[55] Additionally, new legislation is often brought forward in the form of a package, where a combination of different legislative measures is presented together. This can be the case in presenting a directive in combination with regulation, allowing for certain margins of discretions in transposing the former, but ensuring other directly applicable and binding provisions through the latter.[56]

2.3.2 A new impetus for integration: CMU and its objectives

After the financial crisis, not only the De Larosière Report focused on EU financial reform in order to ensure that such a crisis was not to be repeated. Similarly the Commission introduced a Road Map to the Banking Union in 2012, which was to place the financial system on stronger footing and create a more stable banking system.[57] In contrast, the CMU project does not only aim at financial integration to make the financial system more stable, but was also pushed forward to unlock and strengthen investment across Europe and restore investment to levels that were present before the financial crisis.[58] The ambitious CMU project of financial market integration was therefore presented as an important part of the Third Pillar of the Investment Plan for Europe.[59] This project was one of the most important political guidelines presented by Jean-Claude Juncker when he assumed his presidency of the European Commission in 2014. His opening speech to the European Parliament focused largely on how jobs and growth could be stimulated in the EU, and he set out what important role the Capital Market Union would play in this project. In this manner, the CMU project is supported by an additional political incentive for financial integration, aside from financial stability.

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[54] A. Enria, '*The Single Rulebook: is it Single Enough?*', Speech at the University of Padova, 28 September 2015. Available at: https://www.eba.europa.eu/documents/10180/1208645/2015+09+28+-+Single+Rulebook+at+UniPadova.pdf. P. 2.

[55] N. Moloney, 'Reform or Revolution? The Financial Crisis, EU Financial Markets Law, and the European Securities and Markets Authority', *International and Comparative Law Quarterly* 2011b, Vol. 60, No. 2, pp. 521-533. P. 525.

[56] The Market Abuse package of 2014 can be considered an example of this trend. This package consists of a regulation, and a directive on criminal sanctions for market abuse, and replaces the Market Abuse Directive of 2004. Other examples are the Capital Requirements Directive IV ('CRD') in combination with the Capital Requirements Regulation ('CRR'), as well as the Markets in Financial Instruments Directive II (MiFID II), in combination with the Markets in Financial Instruments Regulation ('MiFIR').

[57] Commission, *A Roadmap towards a Banking Union* (Communication), COM(2012) 510 final, 2012a. Pp. 3-4.

[58] Commission 2017a. P. 2.

[59] Commission, *An Investment Plan for Europe* (Communication), COM(2014) 903 final, 2014a.

The CMU project distinguishes itself from previous attempts of financial integration in different ways. Firstly, the CMU project uses a particular holistic approach of integration as opposed to earlier attempts of financial integration. The Commission makes use of positive integration by harmonizing new regimes or issuing new standards, but also negative integration by liberalizing other aspects of financial markets.[60] By introducing new actions separately, the Commission aims to construct the CMU from a bottom up perspective, measure by measure.[61] Its 'First Status Report' identified 33 separate actions, ranging from amending existing legislation,[62] to calling for tenders to investigate policy frameworks.[63] These include both long-term measures, such as fostering convergence of insolvency proceedings, and short-term priorities. These shorter-term pioneers of the CMU project are led by a review of the Prospective Directive and a harmonised regime for Simple, Transparent, and Standardised ('STS') securitisations.[64] This resulted in a newly passed Prospectus Regulation, and a final text of a Securities Regulation to be voted on by the Council and the Parliament. These will be assessed under Chapter 7.

The CMU agenda has set both targets to promote integration in some very specific areas, such as assessments on the impact of MiFID II level 2 rules on listed SME equity, as well as wider market building, for example through studying discriminatory tax obstacles to cross-border investment by pension funds or life insurers. This is particularly relevant in contrast to the previous wave of financial reform and integration after the financial crisis. Whereas the CMU attempts to engage in market-building for capital, the previous wave saw to market shaping.[65] In market-shaping an already established market is subjected to new rules to shape this market, rather than that rules are used to stimulate and build a new market (for capital). An example of market-shaping would be the European Banking Union, where the existing market for banking activities is subjected to new regulation, and is hence shaped by the legislator rather than constructed.

In this regard, it should be noted that the Commission makes use of a broad definition of what

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[60] N. Moloney, '*European Financial Regulation and Supervision: The Capital Markets Union Challenge'*, Keynote Speech at LUISS, 4 December 2015. Available at: https://www.youtube.com/watch?v=6OJHYeF4ouI&t=1554s. An example of liberalization can be found in the Prospectus Regulation, which adjusts the threshold for filing prospectuses so that less parties are faced with these rules. or the legislative proposal specifying conflict of laws rules for third party effects of transactions in securities and claims as a measure of specific harmonization with the Communication (roadmap) to address remaining Giovannini barriers and other barriers. Examples of further harmonization are the Securities Regulation, creating new mandatory infrastructures for issuing STS securitisations.

[61] E. Micheler, 'Building a capital markets union – improving the market infrastructure', *European Business Organization Law Review* 2016, Vol. 17, No. 4, pp. 481-495. P. 482.

[62] Examples include Solvency II or CRR.

[63] Examples include tender studies into retirement savings and targeted action on securities ownership.

[64] Commission, *Capital Markets Union: Accelerating Reform* (Communication), COM(2016) 601 final, 2016a. Pp. 2-3.

[65] Moloney 2015.

Capital Markets constitute. It has included aside from the bonds and securities markets, also crowd funding and private placements of loans and securities, which are not the traditional capital markets outlined as defined under 2.1.[66] A particular emphasis is placed by the Commission on the fact that it aims to integrate capital markets "that are used for raising longer term finance, such as the purchase of shares, or for loans that are not expected to be fully paid back for at least a year."[67] The wide scope set out by the CMU project allows for a broad mandate to tackle different fields of competences. This has a strong advantage in the sense that the Commission is encouraged to address the financial issues that also support of other policy fields. A good example is how the broad approach on the CMU project complements and advances the further integration of the EMU. This was already identified in the important Five Presidents Report in 2015,[68] and was reconfirmed recently in the Reflection Paper on the Deepening of the Economic and Monetary Union of May 2017. This paper reaffirms that progress on CMU is paramount to help provide more innovative, sustainable and diversified sources of funding for households and businesses.[69]

The strong ambition of the CMU project is reflected in its four goals. It aims to strengthen the link between savings and growth through: 1. Unlocking more investment from the EU and the rest of the world; 2. Better connecting financing to investment projects across the EU; 3. Making the financial system more stable; and 4. Deepening financial integration and increasing competition.[70] These objectives pave the way for policymakers to introduce regulation that contributes to the construction of a single capital market, rather than the aforementioned market shaping.[71]

An important cornerstone in overcoming the fragmentation of markets lies in the encouragement of supervision. Indeed, a fully integrated financial market does not only mean that market participants are subjected to the same rules and have equal access to sets of financial instruments or services, but also that they are treated equally when they operate in that market.[72] The former refers to the regulations applicable to the market participant, and the latter to the regimes of

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[66] Burn & Greene 2016. P. 341

[67] Commission, *Initial reflections on the obstacles to the development of deep and integrated EU capital markets* (Commission Staff Working Document), SWD(2015) 13 final, 2015c.

[68] J. C. Juncker, *Completing Europe's Economic and Monetary Union. Report by Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz (Five Presidents Report)*, June 2015. Available at: https://ec.europa.eu/commission/sites/beta-political/files/5-presidents-report_en.pdf. P. 12.

[69] Commission, *Reflection paper on the deepening of the Economic and Monetary Union* (Report), 2017b. Available at: https://ec.europa.eu/commission/sites/beta-political/files/reflection-paper-emu_en.pdf. P. 14.

[70] Commission 2015b. P. 3.

[71] Moloney 2015.

[72] M. Baltzer e.a., 'Measuring Financial Integration in New EU Member States', *European Central Bank Occasional Papers* 2008. No. 81. P. 5.

supervision imposed on it. Considering the fact that integration only works best if all parties implement and adhere to the same rules, a convergence of the same standards of enforcement is crucial in the functioning of the CMU project.[73] Now that the first steps such as the review of the Prospectus Directive and the STS Regulation are completed, or drawing at a close, the Commission has identified the development of a consistent and effective supervisory framework as a 'fresh' priority,[74] which entails a the publication of a proposal to reform the European supervisory system by the end of 2017.[75]

2.3.3 Where are we now: CMU's progress

Currently, important steps have been taken to pursue the CMU agenda. Significant in this regard is that the CMU enjoys broad support under the different European institutions. Firstly, support for the project can be found with the European Central Bank (hereinafter: 'ECB'). The President of the ECB has voiced its support for the project on numerous occasions, taking the opportunity to underline the importance of CMU to support the single currency of the Union.[76] Secondly, the European Parliament adopted a Resolution in January 2016 which emphasized the necessity of regulating the European capital markets, and which supported the CMU agenda.[77] Thirdly, the European Council has expressed its appreciation for the CMU project.[78] Lastly, also the Council looks favourably on the pushing forward CMU. The importance of this institutional support is demonstrated by the fact that the Commission, Parliament and Council adopted a joint communication on the legislative priorities of 2017 in which the initiatives on finalising the Prospectus Regulation and Securities Regulation were included.[79] The Prospectus Regulation has now been finalised and the Securities Regulation is in its final stage. The joint support of these institutions hence enables a quick and efficient progression of CMU related legislation.

Relevant to the CMU project becoming a new priority is the imminent departure of the United Kingdom ('UK') from the Union. The departure of Great Britain from the EU, (hereinafter referred to as 'Brexit') leads to the largest financial centre of the EU exiting the single market. Integrating the EU capital markets would offer a competitive environment for British based

[73] Commission 2015c. P. 15.
[74] Commission, *State of the Union 2016: Completing the Capital Markets Union* (Press release), IP/16/3001, Strasbourg, 2016b. Available at: http://europa.eu/rapid/press-release_IP-16-3001_en.htm.
[75] Commission 2017a. P. 19.
[76] Financial Times, *Draghi makes fresh push for Capital Markets Unions,* 2016. Available at: https://www.ft.com/content/a1cea3ac-1383-3b17-bf2f-370232c2cea5.
[77] European Parliament, *Resolution on stocktaking and challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for Financial Regulation and a Capital Markets Union*, 2015/2106(INI), 2015.
[78] European Council, *Conclusions European Council Meeting 28 June 2016*, EUCO 26/16, 2016.
[79] European Parliament, Council & Commission, *Joint Declaration on the EU's legislative priorities for 2017*, Declaration 13 December, 2016. Available at: https://ec.europa.eu/commission/publications/joint-declaration-eus-legislative-priorities-2017_en.

investment firms to resettle on the continent, and for the UK to allow EU investment firms to retain access to its financial markets.

The Mid-Term Review of the CMU project was completed this June, 2017. In this review by the Commission the agenda is assessed, an overview is given of what has completed and what will be identified as new priorities and pillars for the upcoming period. As it stands so far 20 out of 33 measures from the initial Action Plan of September 2015 have been completed. From the CMU Mid-Term Review it is clear that one of the primary focuses of the Commission will be reviewing the current supervisory framework. Indeed it is identified as the most important priority and being 'at the heart' of the next phase of capital markets integration.[80] Now that the open consultation reviewing the modus operandi of the European Supervisory Authorities has been concluded, it is expected at the time of writing that the Commission will issue a White Paper or legislative proposal, which will reform these ESAs by November 2017.

The CMU must therefore be seen as an important new project that aims at financial integration in order to enhance financial stability and high quality regulation, but also aspires to attract and stimulate investment and economic growth. The Commission has shown that its ambitions have to be taken seriously as it has been able to follow up on a many of its intentions originally announced in its Action Plan. Backed by wide support from other EU institutions, it now aims to accomplish its objective of achieving supervisory convergence, amongst other means by reviewing the supervisory architecture by reviewing the ESAs.

[80] Commission 2017a. P. 10.

"*The District Commissioner spoke to them again about the great queen, and about peace and good government. But the men […] just sat and looked at him and at his interpreter.*"
- Chinua Achebe, Things fall apart

3. Financial Governance in the EU

In this chapter I shall provide an overview of the developments that have taken place in EU financial governance. In order to comprehend the current mode of governance, I shall first commence by describing the general changes in EU governance under section 3.1. Secondly, I shall see how these changes in EU governance are reflected in the financial governance of the Union under 3.2. Lastly, I shall provide a brief overview of how international financial governance influences these processes. This third chapter will allow me to put certain developments from the previous chapter into perspective, prior to describing the different governance models that are applicable to supervisory convergence (chapter 4).

3.1 New governance in the EU

When discussing governance throughout this chapter I shall make use of the definition as used by the Commission, where governance is defined as: "'*Governance' means rules, processes and behaviour that affect the way in which powers are exercised at European level, particularly as regards openness, participation, accountability, effectiveness and coherence*."[81]

Both in academia and in practice, a strong debate has been taking place on new forms of governance in the EU. After the introduction of the Open Method of Coordination at the Lisbon Summit of 2000, followed by the publication of the Commission's White Paper on European Governance,[82] an entire new discussion was sparked on how governance in the EU changed, or should be amended in order to fulfil the objectives of the EU. A strong emphasis in this discussion is devoted to new forms of governance that have replaced the traditional hierarchical models. The scope of this debate is overwhelming. Shifts in modes of governance are identified and categorized differently by looking into the relevant actors, tools or instruments, architecture or networks, procedures, modes, or definitions of the concept of law.[83] Hence, numerous ways of categorizing 'new governance' in the EU co-exist in both the policy and academic debate.[84] To

[81] Commission, *White Paper on European Governance* (Communication), COM(2001) 428 final, 2001. P. 6.
[82] Commission 2001.
[83] See amongst others: K. Armstrong & C. Kilpatrick, 'Law, Governance, Or New Governance? The Changing Open Method of Coordination', *Columbian Journal of European Law* 2007, Vol. 13, No. 3, pp. 649-678.
[84] P. Craig & G. De Búrca, *EU Law: Text Cases and Materials*, Oxford: Oxford University Press 2015. P.

analyze the new modes of governance through one perspective is therefore by definition a simplification of the complicated and extensive debate. However, in order to provide for a concise discussion this chapter shall take two focal points for discussing modes of new governance: the architecture of governance and the how different frameworks can be categorized as models.

3.1.1 New Governance – Architecture of governance

A definition of new governance that resonates with many different authors in the literature is that of the shift away from 'government'.[85] This implies that such a shift is accompanied by a move away from hierarchical decision-making by centralized public actors.[86] Instead new governance is characterized by a different architecture of actors that use different instruments to shape, coordinate and implement policy.[87] In contrast to government, (new) governance is often characterized by relations between public and private actors, that coordinate their (inter)actions through formal or informal instruments.[88] Hence, these relationships often have a stronger societal focus than the traditional government focused models that look at the influence exerted by a central public authority.[89] This means that decision-making and policy is influenced by a variety of actors and often occurs outside of the previously established forms and procedures.

In the case of the EU, there are different ways in which this form of new governance manifests itself. One of the most obvious methods to identify these new ways of governance is by looking at the changes compared to the traditional decision-making model in the EU. Scott and Tubrek argue in their defining article that within the EU any divergent method of governance from the 'classic Community Method' ('CCM') can be considered as a form of new governance.[90] This form of decision-making is set out in the aforementioned Commission White Paper as the ordinary legislative procedure as laid down under Art. 294 Treaty on the Functioning of the European Union ('TFEU'). The White Paper underlines that in this regard it is of particular importance that the Commission exercises the right of legislative initiative, the Council represents the Member States, and the Parliament represents the citizens of the Union. Under this

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[85] B. Kohler-Koch & B. Rinberger, 'Review Article: The 'Governance Turn' in EU Studies', *Journal of Common Market Studies* 2006, Vol. 44, No. 27. Pp. 27-49. Authors that concur with this definition or use a similar one in their literature include: Craig & De Búrca 2015. P. 163. Armstrong & Kilpatrick 2007. P. 651. A. Heritier, M. Stolleis & F. Scharpf (eds.), *European and International Regulation after the Nation State: Different Scopes and Multiple Levels,* Baden-Baden: Nomos 2004.

[86] Kohler-Koch & Rinbercher 2006. P. 28.

[87] C. Scott, 'Governing Without Law or Governing Without Government? New-ish Governance and the Legitimacy of the EU', *European Law Journal* 2009, Vol. 15, No. 2, pp. 160–173. Pp. 165-167.

[88] Kohler- Koch & Rinbercher 2006. P. 29.

[89] Pierre 2000. Pp. 3-4.

[90] J. Scott & D. Trubek, 'Mind the Gap: Law and New Approaches to Governance in the European Union', *European Law Journal* 2002, Vol. 8, No. 1, pp. 1-18. P. 1.

method the Court of Justice of the European Union ('CJEU' or 'the Court') guarantees the rule of law.[91] This means that any act adopted conform the CCM qualifies as a legislative binding act adopted by the Union that is uniformly applicable to all Member States.[92] Hence, traditional governance consists of: 1. centralized, top down policy that is 2. binding, and 3. uniform. Accordingly, decision-making that does not qualify under such a method falls under new governance.

Scott and Tubrek make this explicit by attributing six defining characteristics to new governance. Firstly, they state that new governance is focused on participation and power sharing. Through inclusive methods or networks, new governance involves new stakeholders in the decision-making process. Secondly, new governance is multi-level integrated. Due to the different stakeholders, often new governance will include a multi level structure that allows for dialogue between private parties, local or national authorities, or European level institutions. Thirdly, new governance allows for diversity in the approaches amongst the actors to a problem. Assisting policies through coordination is hence an important aspect of new governance, rather than striving for a uniform approach. Fourthly, it is possible for deliberation to take place between actors for them to jointly coordinate choices in decision-making, which helps in problem solving capacity and adds a certain degree of democratic legitimization. Fifthly, governance mechanisms are revisable and flexible to a large extent. This is often due to the fact that they rely on soft law, and not necessarily legally enforceable provisions. Lastly, new governance provides methods of experimentation through which new knowledge can be acquired. Due to the open ended coordination, "[n]*ew knowledge may come from deliberative processes, from combining local experimentation with multilateral surveillance, and from formal and informal ways of exchanging results, benchmarking performance, and sharing best practices*."[93] Additionally, the methods of new governance are an open, flexible group and can exist in all forms such as peer reviews, coordination, comitology, or technical standard setting (as long as they do not qualify under Art. 294 TFEU).

Sabel and Zeitlin contribute to the discussion by identifying their own four criteria that they consider as defining for new governance. They state that decision-making is first of all deliberative. Actors convene or communicate through networks or committees, through which they collectively establish the best policies. Secondly, this deliberation is characterized by being 'informal'. The networks that are established are not necessarily all cast in the same mould, but provide flexible ways and new forms of communication and coordination between the actors.

[91] Commission 2001. P. 6.
[92] Scott & Trubek 2002. P. 2.
[93] Scott & Trubek 2002. Pp. 5-6.

Thirdly, this communication is considered to be of a 'multi level' character. In the EU, these networks or committees of national authorities connect with the higher EU level institutions or actors in order to communicate policy choices, hence creating a multi-level structure of networks and coordination. Lastly, new governance signifies a departure from the traditional norms of representative democracy, where decision-making is only legitimate if it has taken place in an elected assembly on the basis of a legislative act, instituted by a sovereign electorate.[94]

The observation should be made that the rise of this phenomenon does not preclude the fact that the ordinary legislative procedure is subordinate, or less relevant in any way to methods of new governance. However, the rise of new governance does mean that the ordinary way of decision-making is no longer the only established way.[95] There is a broad consensus in the academic literature that this new governance in the EU is associated with the need for more effective and pragmatic ways of decision-making that overcame the cumbersome, and often-bureaucratic procedures of the ordinary legislative procedure.[96]

Trubek and Scott argue that there are six factors that allow new governance to be an effective solution to the problems faced in decision-making. Firstly, they observe increasing complexity and uncertainty of issues on the EU agenda as a contributing factor. New governance allows for diverse and innovative approaches to complex problems, faced in a dynamic and uncertain environment of policy choices. Issues such as financial stability can be tackled swiftly and with greater expertise than through a static and prolonged legislative procedure. Secondly, the diversity of the EU makes new governance particularly suitable as a way of governing. Uniform rules are often ineffective due to the complexity of different regulatory landscapes, cultures and practices. New governance can provide through flexible measures a more appropriate solution. Thirdly, this development of new governance is a reflection of a broader, ongoing trend in public and administrative law. Fourthly, new governance allows for coordinated governance, where the EU might not be competent or has limited competency. New governance provides a solution to this problem through coordination amongst Member States, possibly via a central positioned EU institution. Fifthly, new governance is particularly used in the EU to enhance the legitimacy of the EU. Because it involves a wide range of stakeholders, it is considered by Scott and Trubek to

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[94] C. Sabel & J. Zeitlin, 'Learning from difference: the new architecture of experimentalist governance in the EU', *European Law Journal* 2008, Vol. 14, No. 3, pp. 271–327.

[95] Craig & De Búrca 2015. Pp. 164-165.

[96] Scott & Trubek 2002. P. 6. Sabel & Zeitlin 2008. P. 272. G. De Búrca, 'New governance and experimentalism: an introduction', *Wisconsin Law Review* 2010, Vol. 2010, No. 2, pp. 227-238. P. 229. E. Ferran, 'The Existential Search of the European Banking Authority', *European Business Organization Law Review* 2016, Vol. 17, No. 3, pp. 285-317. P. 292. E. Posner, 'International financial regulatory cooperation', in: J. Zeitlin (ed.) 'Extending Experimentalist Governance?: The European Union and Transnational Regulation', Oxford: Oxford University Press 2015. P. 15.

be an inclusive way of decision-making. Lastly, new governance is suggested to be on the rise due to the subsidiarity principle. Conform this principle the Union is only able to regulate particular spheres when it is in a better position than the Member States. This means that it searches for new ways to influence decision-making in different ways.[97]

Another leading form of explanation for new governance is the stream in literature referred to as 'experimentalism'. Sabel and Zeitlin, two leading proponents of this concept, argue that due to the uncertainty and turbulent decision-making environment, new governance must be mainly seen as a form of experimental policy making. Under this form of governance, the regulatory architecture firstly allows the parties involved to set a number of goals. Secondly, the relevant decentralized authorities or institutions remain free to pursue these goals in their own way of choosing, within the bounds imposed on them through the network. Thirdly, these actors report back on their achievements in accomplishing the goals. Lastly, the goals and measures are reviewed and evaluated through the network, after which successful experiments can be repeated.[98] This form allows identification of the best methods of decision-making through recurring experimentation and hence herald new governance predominantly for its innovation, and reflexive nature during times of crisis.[99]

3.1.2 New Governance – Models of New Governance

Authors disagree however on what the introduction of new methods of governance means in practice. Different modes and models can be found in the literature depending on the scope of elements that authors include in their assessments such as hierarchy, institutions, enforceability, actors or instruments. Armstrong and Kilpatrick highlight the abundance of different categorizations in the field in a concise overview:

"Kooiman distinguishes between "hierarchy," "self-regulation," and "co-regulation" modes. Bulmer and Padgett distinguish between governance by "hierarchy," by "negotiation," and by "facilitated coordination." Colin Scott suggests a four-fold classification of "control models"- "hierarchy," "competition" or "market," "community," and "design"-while Newman proposes a somewhat different classification of "hierarchical," "self-governance," "rational," and "open systems" models. While all agree on "hierarchy" as a mode or model, the non-hierarchical candidates are differently categorized. This may explain why it is easier to define new modes of governance by what they are not-hierarchy-than how they might be characterized independently of the comparison. […] Scharpf, in discussing the "plurality of European governing modes"

97 Scott & Trubek 2002. Pp. 6-8.
98 Sabel & Zeitlin 2008. Pp. 290-291.
99 Craig & De Burca 2015. P. 181.

identifies a triptych of modes: (I) supranational centralization; (2) joint decision-making; and (3) intergovernmental agreement." Like Wallace, these are perhaps more composite categories referring to a variety of features-actors, institutions, instruments and styles of policy-making- rather than purely abstracted rationalities of governance."[100]

The result is therefore that the system of new governance, in the EU can be given different categorizations: whether governance systems in financial law are described as "hierarchy/self-regulation/co-regulation", or "hierarchy/negotiation/facilitated negotiation" is a matter of what lens one chooses to assess the developments in a particular area of EU governance. The models of categorization however fit strongly with the architectural elements that are identified concerning, hierarchy, coordination, and the degree to which one is bound by the forms of governance. As indicated above, the existing options of categorisations are of such a wide and varying scale in the literature, that choosing one in particular means already in advance other valid models of categorization are excluded. However, the outlined discussion above of new governance in the EU provides an important theoretical framework, which will serve to explain certain changes in EU financial governance over the past years, and the years to come.

3.2 Financial Governance in the EU

Governance on the single financial market of the Union serves as an interesting case study of new governance. All 28 Member States in the Single Market are subject to a harmonized set of rules under the Single Rulebook, the regulatory initiative that resulted out of the De Larosière report.[101] Additionally, all Member States are to co-operate with the ESAs, whose creation envisaged a coordinating role between the national authorities of Member States.[102] As briefly pointed out under 2.3.1, the new ESAs form a part of the revised Lamfalussy procedure. This means that accordingly they can draft technical standards on the second level. Additionally they can set out measures of soft law through the adoption of guidelines or recommendations, with which NCAs must try to comply with.[103] This leads to the ESAs being identified as quasi rulemaking authorities.[104] It is precisely these forms of governance that makes ESAs an excellent example of new governance. Not only are the decision-making procedures greatly divergent from the ordinary legislative procedure as understood to be the CCM, but there is also a large degree of coordination between the NCAs and the ESAs, taking away from a hierarchical character of their

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[100] Armstrong & Kilpatrick 2007. Pp. 653-654.
[101] De Larosière 2009. Pp. 27-29.
[102] De Larosière 2009. Pp. 55-57.
[103] E. Chiti, 'European Agencies' Rulemaking: Powers, Procedures and Assessment', *European Law Journal* 2013, Vol. 19, No. 1, pp. 93–110. P. 95.
[104] M. Busuioc, 'Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope', *European Law Journal* 2013, Vol. 19, No. 1, pp. 111–125.. P. 113

operational framework. Indeed it is argued that they function on a "*broadly decentralized institutional arrangement for coordinating supervision and supporting technical rulemaking*".[105] Additionally, in many of their risk assessing capacities the ESAs make use of wide market consultations that allow them to reach out to different market participants, both public and private. Another important tool that the ESAs have at their disposal are the options of facilitating peer reviews between different Member States, where supervisory practices are evaluated.[106] In this manner, new and old supervisory practices are re-evaluated and new best practices are brought to light. Similarly the capacity to engage in bench mark setting for other national authorities or issue consultations for supervisory practices has allowed for exploration and a flexible way of shaping policy. This way of identifying the best financial governance policies, fits well with Sabel and Zeitlin's explanation of how experimentalism is shaping new governance in the EU.

The advantage of these new forms of financial governance is that the bypassing of the CCM allowed a wide number of legislative integration measures to be passed. Already under the initial Lamfalussy framework, directives that were previously blocked under ordinary legislative procedure could now be introduced more swiftly.[107] Without obstacles such as the qualified majority voting in the Council, capital market integration received a new boost. Additionally, the ESAs have now been enabled to respond in a flexible manner to complex issues of policy making, and revise policy decisions or procedures, particularly in times of crisis.[108]

After the De Larosière revisions to the Level 3 Committees, however, the frameworks of the ESAs have become more centralized and gained a more hierarchical character.[109] As emphasized before, this was largely due to the fact that the pre-crisis framework did not provide for effective and enforceable supervisory consistency between supervisors, and lacked the means for

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[105] N. Moloney, 'The European Union in international financial governance', *RSF: Russell Sage Foundation Journal of the Social Sciences* 2017, Vol. 3, No. 1, pp. 138-152. P. 143.

[106] Article 8(1) sub e of the respective founding regulations: Regulation 1093/2010/EU of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority), Regulation 1094/2010/EU of the European Parliament and of the Council establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation 1095/2010/EU of the European Parliament and of the Council establishing a European Supervisory Authority ('ESMA Regulation').
See also: N. Moloney, 'The European Securities and Markets Authority and institutional design for the EU financial market - a tale of two competences: part (2) rules in action', *European Business Organization Law Review* 2011c, Vol. 12, No. 2, pp. 177- 225. P. 180. Posner 2015. P. 15.

[107] J. Zeitlin, 'EU experimentalist governance in times of crisis', *West European Politics* 2016, Vol. 39, No. 5, pp. 1073-1094. Pp. 1077-1078.

[108] Zeitlin 2016. P. 1078.

[109] A. Ottow & M. Scholten, 'Institutional Design of Enforcement in the EU: The Case of Financial Markets', *Utrecht Law Review* 2014, Vol. 10, No. 5, pp. 80-91.P. 83.

supervisors to challenge cross-border supervisory practices.[110] The ESAs received new competences to issue instructions to NCAs or market participants or to take action in the cases of a breach of EU law. Even though, they still operate on a co-operation model that has strong experimental features,[111] the ESAs have unmistakeably been reaffirmed as central authorities in their network.[112] Co-operation elements lie in that the supervisory boards of the ESAs are still composed of the heads of the NCAs.[113] Additionally all collective decision-making "*is subject to extensive requirements for prior consultation with other EU institutions and external stakeholders, as well as to formal procedures for challenge and appeal as it affects third parties*".[114] Whilst these are valid arguments as to why the ESAs still function on an experimentalist basis, however, the process of further centralization in EU financial governance over the past years is indisputable. Even though the NCAs have become more active in the governance of the ESAs, this does not take away from the fact that they can also be bound to a far greater extent in their obligations towards the ESAs. Through the briefly mentioned principle of 'comply with instructions of an ESA, or explain', the NCA might find them in a significantly criticized position by the network, which might even result in a breach of EU law position being instigated against the particular NCA under Art. 258 TFEU.[115] This forms a significant contrast with the predecessors of the ESAs and the Lamfalussy framework, which were still presented as having respect for discretion and local knowledge.[116]

Zeitlin observes that precisely due to this centralization, NCA's have become more involved and engaged with the governance of the ESAs, and have hence supported 'a deepening' of the experimentalist governance.[117] Even though it appears to be a contradiction, a degree of centralization of power in the ESAs has led in practice to stronger coordination amongst the network of national authorities. However, as noted above this centralization has been accompanied by further maximum harmonization in capital markets, providing for less flexible rules, applicable to all market participants. I would therefore argue that whilst the ESAs and EU financial governance, still retain many cooperative and decentralized elements characterizing of new governance, a shift away from new governance can still be observed. An important

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110 De Larosière 2009. Pp. 40-41.
111 M. Campbell-Verduyn & T. Porter, 'Experimentalism in European Union and global financial governance: interactions, contrasts, and implications', *Journal of European Public Policy* 2014, Vol. 21, No. 3, pp. 408-429. P. 414.
112 Moloney 2011a. P. 53.
113 Ferran 2016.
114 Zeitlin 2016. P. 1079.
115 C. V. Gortsos '*The powers of ESMA in case of a breach of European Union law: the particular case of breaching the "non bis in idem" principle*' (December 27 2016), 2016a. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2890444.
116 Sabel & Zeitlin. 2008. Pp. 296-298.
117 Zeitlin 2016. P. 1079.

observation remains that due to the different spheres of activity, the ESAs activities and institutional arrangements have evolved along different lines, which allows for variation in the regulatory process.[118] It is precisely this variation that has allowed the ESAs in their respective field to anticipate, and engage in solutions for complex financial dilemmas that require problem solving,[119] which is defining for these methods of new governance.[120]

This trend of centralization towards a single, more hierarchical authority is particularly visible for the Member States of the Eurozone. These Member States are additionally bound by the obligation they have under the Banking Union. Under this project, the ECB has been appointed the main supervisor for all significant credit institutions under the Single Supervisory Mechanism ('SSM').[121] Though some authors maintain that this too can be categorized as experimental new governance due to the "mixes of member state input, lack of permanently specified central powers and variations in the degrees of direct EU-level supervision for financial institutions of different sizes",[122] it is indisputably a return to a form of hierarchical, central command. The decisions by the ECB can override those of national authorities, even in the cases of smaller credit institutions, not directly under the supervision of the ECB.[123] More attention will be given to this in the following section on supervisory convergence.

A last, brief comment should be made on the impact of international financial governance on the EU. International financial governance is characterized by a divergent range of international organizations and platforms that co-operate through standard setting and coordination such as the International Organization of Securities Commissions ('IOSCO'), the Bank for International Settlements, and on the other hand financial organizations that provide an additional surveillance role such as the IMF or the World Bank.[124] Additionally, the G20 played a strongly influential role in the creation of the overarching Financial Stability Board ('FSB').[125] This body fulfils the role of an international platform that monitors systemic risk and globally provides oversight.[126]

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[118] Campbell-Verduyn & Porter 2014. P. 414.
[119] Zeitlin 2016. P. 1079.
[120] Scott & Trubek 2002. Pp. 16-17.
[121] Art 1. In Conjunction with Art. 6 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation).
[122] Campbell-Verduyn & Porter 2014. P. 415.
[123] A. Kern, 'The ECB and Banking Supervision: Does Single Supervisory Mechanism Provide an Effective Regulatory Framework', in: M. Andenas & G. Deipenbrock (eds), *Regulating and Supervising European Financial Markets*, Cham: Springer International Publishing 2016a. P. 253.
[124] Posner 2015. Pp. 198-199.
[125] F. Moshirian, 'The global financial crisis and the evolution of markets, institutions and regulation', *Journal of Banking & Finance* 2011, Vol. 35, No. 3. pp. 502–511. P. 502.
[126] A. Kern, 'Selected Aspects of International Regulation and Policy: Reforming International Financial Regulation Along Macro-Prudential Lines', in: M. Andenas & G. Deipenbrock (eds), *Regulating and Supervising European Financial Markets*, Cham: Springer International Publishing 2016b. P. 218.

Whilst these bodies exert a considerable amount of influence, their issued guidelines and guidelines are predominantly of a non-binding character, *"[w]hose decentralized implementation ultimately depends on their transposition into national and regional regulation*."[127]

Whilst individual Member States and their institutions might be represented in some of these boards, the Commission often has a seat at the table in order to represent the interests of the entire Union, or this role is assigned to the ECB, or in exceptional cases for both.[128] Whilst not *directly* influencing the decision-making in these international platforms, also the ESAs can exert influence on the stage of international financial governance. Their founding regulations enable them to "develop contacts and enter into administrative arrangements with supervisory authorities, international organisations and the administrations of third countries."[129]

Therefore international financial governance characterizes itself especially as a method of experimental governance through which new guidelines reach the legal sphere of the Union. However, seeing as the Union has gained more and more credibility in international financial forums it is also not unfeasible to state the Union has commenced influencing the international forums with standard setting that has come about through an experimental way.[130]

3.3 Concluding remarks

New governance is a broad definition for untraditional methods of decision-making that happens in an open, reflexive manner. It is characterized by a non-hierarchical, decentralized form of deliberation that is non-binding to the actors in the network. New governance is also visibly in the financial governance of the EU and its financial markets, for example in the creation of the Lamfalussy process. Whilst this process was successful in EU financial governance in integrating large parts of the financial markets, the heavy reliance on coordination resulted in a return to centralization. This is evidenced by the previous committees of regulators that were transformed into the current ESAs as we know them. These authorities retain certain coordination features, which are characteristic of new governance. In the next sections we shall first see how supervisory convergence can make use of new governance methods to achieve its aim, or resort to further centralization (chapter 4).

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[127] Campbell-Verduyn & Porter 2014. P. 420.
[128] For example in the FSB, the ECB and the Commission both have a full seat with voting rights. In the Basel Committee the ECB has two seats, both as supervisor and as monetary authority. Within the IOSCO the Commission has a seat, but no voting rights. Moloney 2017.
[129] Art. 33 ESMA Regulation. Moloney 2017. P. 144.
[130] D. Mügge, 'Europe's regulatory role in post-crisis global finance', *Journal of European Public Policy* 2014, Vol. 21, No. 3, pp. 316-326. P. 322.

"What was on my mind as I was walking that wire? I was thinking: if I can do this…
Then I have two ways to cross the yard."
- Modern Family, Phil on Wire

4. Supervisory Convergence: two models

In this chapter supervisory convergence will be discussed. However the difference between regulation and supervision can be clear in theory, but in practice the line often seems permeable.[131] Where regulation constitutes the drafting and creation of rules, supervision sees to apply this regulation in practice upon market participants. This is done through administrative monitoring and enforcement.[132] For example, regulation in the form of soft law standards can shape supervisory practices. But the act of supervising individual financial institutions can also contribute to identifying best supervisory practices, which in turn can be codified into guidelines.

Though earlier defined as 'the same application and implementation of the same rules, using similar approaches', supervisory convergence does not necessarily mean that a one-size-fits-all approach is necessary. The overall goal remains to achieve 'comparable', or the same outcomes.[133] I argue that two models of institutional design can be discerned on how supervisory convergence can be achieved. These two models lie on the two extremes of a spectrum. Variations or combinations of these two opposites can be found in between the two extremes. However, in order to clearly assess the advantages and limitations of each model, I have chosen to describe only the two contrasting models in order to exemplify the clear dichotomy.

Policymakers will often carefully consider their options in deciding on how to regulate institutional governance of supervisory institutions.[134] On the one hand there is the centralized model, where direct supervisory powers are concentrated in a single supranational supervisor. On the other hand, there is the network model, where NCAs coordinate their supervisory activities amongst each other, possibly with the help of a central platform or organization. Below I shall briefly discuss these two institutional models and their respective strengths and weaknesses. The centralized -, and network model have been discussed in various contexts of governance such as

[131] N. Moloney, 'Supervision in the Wake of the Financial Crisis: Achieving Effective 'Law in Action' – A Challenge for the EU', in: E. Wymeersch, K.J. Hopt, G. Ferrarini (eds.), *Financial Regulation and Supervision: A Post-Crisis Analysis*, Oxford: Oxford University Press 2012. P. 71.
[132] C. Di Noia & M. Gargantini, 'The European Securities and Markets Authority', in: P. Iglesias-Rodriguez (ed.), *Building Responsive and Responsible Financial Regulators in the Aftermath of the Global Financial Crisis*, Cambridge: Intersentia 2015. P. 138.
[133] ESMA 2016b. P. 3.
[134] A. Hennessy, 'Redesigning Financial Supervision in the European Union (2009-2013)', *Journal of European Public Policy* 2014, Vol. 21, No. 2, pp. 151-168. P. 153.

crisis management,[135] but I shall apply these models directly to supervisory convergence.

4.1 Central Supervisory Model

Under the centralized model - also referred to as a "lead agency model" -, one single centralized authority leads and imposes control on network elements within a specific sector or area of competence.[136] In financial supervision this would be a central authority that leads a network of NCAs in the direct control of financial market participants. Underlying the central model is a strong form of risk mutualisation.[137] As participants invest resources to fund a central supervisory model, the failure of such a model will also impact all participants. Such a central authority can be newly created or a previously existing institution that is endowed with new competences. An example of a newly created institution in this field was the Securities and Exchange Change Commission in the United States of America,[138] or the Single Supervisory Mechanism ('SSM'), where the ECB was given new competences as the supervisor of all significant credit-institutions in the Eurozone.[139]

The geographical scope of this model can be international, in which case the authority assumes supranational supervisory competences, or can be on a more national or local scale.[140] Due to its necessity to act on a supranational basis, the central supervisor will often be endowed with far-reaching competences that can be seen to infringe on competences previously belonging to sovereign states. Such competences will endow the authority with a strong hierarchical character. These far-reaching powers are often explicitly reflected in the central authority's mandate during its institutional design. After all, it is important for policymakers to delineate the competences of the central authority clearly, seeing as supranational powers can be at tension with national sovereignty.[141] The process of institutional design is therefore based on a system negotiation and

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[135] A. Boin, M. Busuioc, & M. Groenleer, 'Building European Union capacity to manage transboundary crises: Network or lead-agency model?', *Regulation & Governance* 2014, Vol. 8, No. 4, pp. 418-436. Pp. 418-436.

[136] Boin, Busuioc & Groenleer 2014. P. 423.

[137] N. Moloney, 'International Financial Governance, the EU, and Brexit: The 'Agencification' of EU Financial Governance and the Implications', *European Business Organization Law Review* 2016a, Vol. 17, No. 4, pp. 451-480. P. 474.

[138] Following the Securities Act of 1933 and the Securities Exchange Act of 1934.

[139] T. H. Tröger, 'The Single Supervisory Mechanism – Panacea or Quack Banking Regulation? Preliminary Assessment of the New Regime for the Prudential Supervision of Banks with ECB Involvement', *European Business Organization Law Review* 2014, Vol. 15, No. 4, pp. 449-497.
pp. 456-457. E. Wymeersch, 'The Single Supervisory Mechanism or "SSM", Part One of the Banking Union', *ECGI Working Paper Series in Law*, No. 240, 2014. Pp. 5-6.

[140] Again the SEC and SSM form two examples: where the SEC is a central supervisor across all states within the USA, the ECB supervises on a cross-border scale. It has assumed the role of a supranational supervisor under the SSM, however it still retains a large dependence on the day-to-day supervision by NCAs.

[141] G. Glöckner, J. Lindner & M. Salines, 'Explaining the sudden creation of a banking supervisor for the

compromise where policymakers have to establish the most effective model of centralized supervision without sacrificing too much sovereignty. The final model is therefore based on 'hard law'. This entails that all obligations and duties created in the institutional design will be precise, legally binding and enforceable.[142]

In this regard, a centralized model is not in line with the principles or characteristics of new governance. On the contrary: a great deal of emphasis is put on a central, hierarchical authority, which can issue binding commands. The central model hence accomplishes its objective of comparable regulatory outcomes across different states by empowering the central authority to engage in cross-border oversight. The authority then ensures that it imposes the same standards of supervision on all market actors, across the geographical area for which it is competent. Whilst this use of direct supervision, is the only tool to accomplish supervisory convergence, it can be considered effective as it prevents participating states to protect their own financial institutions through regulatory arbitrage.[143] In the direct oversight, the central authority can still have regard for the differences in business models, types and sizes of supervised institutions as well as the systemic benefits of diversity in the supervised market.[144] The central authority faces the challenge however of retaining direct, qualitative contact with the supervised institutions. This means that whilst the central authority uses one predominant tool to achieve comparable outcomes, its application may be different depending on the relevant context.

A downside of the enforceability of hard law is that it does not allow for a great deal of flexibility in the institutional evolution of a centralized authority.[145] As a centralized organization is more restrained to follow clearly defined tasks, it becomes more difficult for an organization to evolve incrementally or to anticipate on unforeseen circumstances or crises.[146]

The hierarchical position of such a centralized institution provides a strong advantage in terms of efficiency. The concentration of expertise, authority and decision-making in one body allows for synergy effects that can speed up decision-making processes and reduce costs.[147] In contrast to the decentralized network model there is little risk of the activities of different authorities

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Euro Area', *Journal of European Public Policy* 2017, Vol. 24, No. 8, pp. 1135-1153. P. 1136.

[142] E. Ferran & A. Kern, 'Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board', *Cambridge University Legal Studies Research Paper Series*, No. 36, 2011. P. 6.

[143] S. De Rynck, 'Banking on a union: the politics of changing eurozone banking supervision', *Journal of European Public Policy* 2016, Vol. 23, No. 1, pp. 119-135. P. 124.

[144] ECB, *Guide to banking supervision,* 2014. Available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssmguidebankingsupervision201411.en.pdf. P. 5.

[145] Hennessy 2014. P. 158.

[146] Ferran & Kern 2011. P. 7.

[147] Boin, Busuioc & Groenleer 2014. P. 428.

imprecating or interfering with one another. However, the creation itself of such an organization can be slow, cumbersome, and bureaucratic as centralization may require new organizational divides to bring former supervisory subunits under one umbrella organization, or if the scope of supervision is simply too great.[148]

The legitimacy of the central model has both positive and negative sides. Firstly, due to the fact that such a model does not issue soft law, the authority does not circumvent the EU legislator.[149] At the same time, the centralization of power into a supranational supervisor distances this authority from its democratic electorate and is at tension with the sovereignty of participating states. In particular, one can criticize the necessity and subsidiarity of such a model in a multinational legal order, where earlier NCAs were responsible for supervisory work at a decentralized, national level.[150] Secondly, increased centralization of authority leads to an increased concentration of accountability in one actor. Where decentralized, cross-border network approaches of supervisory convergence are difficult to be held accountable; one central supervisor can more easily be identified as a culprit in the case of failure.[151] Thirdly, the increased efficiency in terms of resources use and decision-making could provide a source of legitimacy. This is especially the case if the supervisory authority proves to be effective in times of crisis.[152] Centralization therefore requires important procedural safeguards in the form of checks and balances to be imposed on the powers of such an authority.[153]

4.2 Network Model of Supervisory Convergence

Under the network model NCAs coordinate their supervisory activities amongst themselves in order to achieve comparable regulatory outcomes across different countries. Such a decentralized network entails a distribution of tasks and capacities amongst participants, "where its strength is determined by the strength of the ties between network elements."[154] This can happen through a central platform for communication, or can be coordinated through a third organization that facilitates communication between NCAs.[155] Coordination activities rely therefore heavily on the individual actors within the network. The Committee of European Security Regulators ('CESR') was a good example of such a network model that worked on a voluntary approach in European

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[148] Boin, Busuioc & Groenleer 2014. P. 428.
[149] Ferran & Kern 2011. P. 15.
[150] Verón & Wolff 2016. P. 134.
[151] Boin, Busuioc & Groenleer 2014. Pp. 428-429.
[152] Boin, Busuioc & Groenleer 2014.
[153] P. Iglesias-Rodriguez, *The Accountability of Financial Regulators,* Alphen aan den Rijn: Kluwer 2014. Pp. 19-26.
[154] Boin, Busuioc & Groenleer 2014. P. 423.
[155] Boin, Busuioc & Groenleer 2014. P. 423.

capital markets.[156]

A network model of supervisory convergence uses predominantly soft law tools to achieve the aim of comparable regulatory outcomes, because actors stand in a horizontal and non-hierarchical relationship to each other in the network. In order to foster supervisory convergence the network often relies heavily on information sharing tools as a form soft law in order to coordinate supervisory activities.[157] Such tools can include the sharing of best practices amongst supervisors, exchanging other information, peer reviews, mediation, and creating non-binding agreements, or guidelines on standards of supervisory enforcement.[158] Through peer reviews a central body, or other participants in the network can evaluate each other's supervisory practices.[159] Should conflict about methods of cross-border supervision arise between NCAs a central body could act as a mediator, hence contributing to the settlement on a final (best) practice of supervision.

The network model of supervisory convergence hence is an excellent example of new governance. Its reliance on flexible, non-hierarchical forms of decision-making is characterized by establishing supervisory convergence through soft law measures between NCAs, whilst leaving these NCAs responsible for the implementation of the supervision. Despite the fact that soft law is not legally binding, it can generate practical and legal effects.[160] The use of soft law in the pursuit of supervisory convergence has certain clear strengths. First and foremost, the flexibility of soft law is a strong advantage. The flexibility of soft law enables institutions to quickly adapt to changing circumstances.[161] Especially in financial markets this might be relevant, as these markets are defined by volatility, innovation and the possibility of rapid change.[162] The reliance of the network model on soft law allows for greater innovation in the use of pursuit of supervisory convergence regarding these circumstances. As actors in the supervisory network are not bound by strict legal obligations, they possess a certain margin of discretion, which can enable them to experiment with new methods of supervision.[163] This allows national supervisors to quickly create new, innovative measure to tackle problems and later share these models in order for other NCAs to transplant and apply them in their own markets. Secondly,

[156] Moloney 2011a. P. 61.
[157] Ferran 2012. P. 120.
[158] These examples are taken from practices used by the CESR, which relied heavily on soft law, and a decentralized approach, making it an appropriate case study. Moloney 2011c. Pp. 181-182.
[159] Moloney 2016a.
[160] M. Van Rijsbergen, 'On the Enforceability of EU Agencies' Soft Law at the National Level: The Case of the European Securities and Markets Authority', *Utrecht Law Review* 2014, Vol. 10, No. 5, pp. 116-131. P. 117.
[161] Ferran & Kern 2011. Pp. 6-7.
[162] P. G. Cerny, 'The dynamics of financial globalization: Technology, market structure, and policy response', *Policy Sciences* 1994, Vol. 27, No. 4, pp. 319-342.
[163] Moloney 2011c. P. 192.

inflexible hard law forms of supervision encourage adversarial enforcement towards the supervised market participants, making them expensive and not always as effective. A network model of supervisory convergence based on soft law on the other hand relies more on reputational concerns to generate informal agreements and reciprocal relationships between the supervisor and the market participants.[164] Indeed, it is stated that soft law's primary objective is to produce dominant norms with which to coordinate behaviour, rather than commanding behaviour.[165]

An argument in favour of the network model is that its strength lies in its diversity. Due to the fact that the network is built up out of different supervisory authorities and other actors can influence decision-making in the network, this can generate a stream of detailed information. The network has connections with local sources, and can hence not only yield great amounts of information, but also diverse, and more complete information. This information is often collected by experts in decentralized authorities, which are well acquainted with their respective local fields.[166] This means that there is awareness, and even expertise of differences in the implementation of supervision. The other side of the coin however is that this information is not impartial or can easily become politicized due to the favouring of national supervisees or so called "national champions".[167] Hence, the quality of the network is dependent on the willingness of participants to share information.[168] Afterwards this information still needs to be aggregated, processed and distributed within the network, giving rise to inefficiencies. Furthermore, such inefficiencies can be found in the size of a network. If it consists of diffused nodes and connections there is a reasonable chance that participants work on the same problems or fail to coordinate amongst themselves, giving rise to situations of miscommunication.[169] A certain degree of centralization can therefore help in the coordination process.

An additional advantage of the network model is that it respects the sovereignty of the participating states. This provides the network with a certain amount of legitimacy, as it respects the democratically established institutions.[170] This makes the model a lot less politically sensitive and encourages participation, as opposed to a central supervisory authority.[171] However, an important constraint on the network model is the difficulty to hold the network accountable for

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164 Hennessy 2014. P. 154.
165 C. Brummer, *Soft Law and the Global Financial System: Rule Making in the 21st Century,* Cambridge: Cambridge University Press 2015. P. 132.
166 Boin, Busuioc & Groenleer 2014. P. 425.
167 De Rynck 2016. P. 124.
168 Boin, Busuioc & Groenleer 2014. P. 425.
169 Hennessy 2014. P. 152.
170 Boin, Busuioc & Groenleer 2014. P. 426.
171 N. Moloney, 'Capital Markets Union: "ever closer union" for the EU financial system?', *European Law Review* 2016b, Vol. 41, No. 3, pp. 307-337. Pp. 333-334.

arising shortcomings or failures. Due to the diffusion of tasks and responsibilities across the network, mistakes are difficult to attribute to the network or individual actors.[172] Lastly, an important factor that undermines the legitimacy of the model is its failures in the past, especially in regard to financial supervision. This is perhaps the strongest argument against the network model. For example, the failure of the supervisory network of the CESR to adequately enforce its supervisory standards has been listed as shortcoming leading to the financial crisis in Europe.[173] Hence, too much respect for sovereignty can give leeway to too much discretion for national regulators and supervisors, making the model incapable of achieving convergence.[174]

4.3 Assessment

By emphasizing the strong differences between these two models, the advantages and disadvantages of each model become clear in the dichotomy. Both models of supervisory convergence are characterized by the nature of law they use. The centralized model is built upon clearly defined and enforceable tasks, and obligations. Through its use of hard law and direct supervision of credit institutions it imposes the same standards on all market participants, making the objective of comparable outcomes likely to be achieved. It is characterized by a central hierarchical authority. However, the model is rigid and impedes on sovereignty of participating nations, making it controversial.

The network model on the other hand relies on soft law, and is in contrast defined by a decentralized architecture. This makes it more flexible, but also makes its success dependent on voluntary participation.[175] Furthermore, a lack of clear obligations and central coordination might lead to inefficiencies within the network. However, in practice not every model of supervisory convergence is so clearly defined. Often an authority or network that strives for supervisory convergence will have an institutional design that combines elements from both models, as policymakers often consider endowing such an entity with both a mix of hard and soft law in the framework.[176] The aforementioned example of the SSM still relies for example still heavily on the co-operation of NCAs for the execution of day-to-day supervision.[177] Due to contextual

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[172] M. Bovens, D. Curtin & P. 't Hart, 'Studying the Real World of EU Accountability: Framework and Design', in: M. Bovens, D. Curtin & P. 't Hart (eds.), *The Real World of EU Accountability: What Deficit?*, Oxford: Oxford University Press 2010.
[173] De Larosière 2009. P. 79.
[174] De Rynck 2016. P. 126.
[175] Brummer 2015. P. 132.
[176] Hennessy 2014. P. 158.
[177] See for example: C. V. Gortsos, 'Competence Sharing Between the ECB and the National Competent Supervisory Authorities Within the Single Supervisory Mechanism (SSM)', *European Business Organization Review* 2015, Vol. 16, No. 3, pp. 401-420.

considerations there is no one-size-fits-all model of supervisory convergence. Instead, a model of supervisory convergence often contains traits of both extremes. In the next section I will set out how the model for supervisory convergence is reflected in the European framework.

"Light is meaningful only in relation to darkness, and truth presupposes error. It is these mingled opposites […], which make it pungent, intoxicating. We only exist in terms of this conflict, in the zone where black and white clash."— Louis Aragon

5. Supervision on European Capital Markets: the Role of ESMA

Before being able to assess how the CMU project promotes supervisory convergence, it is important to paint a picture of the current landscape of supervisory authorities on the European capital markets. In this chapter I shall pay particular attention to the role played by ESMA's role in this framework. I shall first of all provide an overview of the tasks, powers and attempt to place it within one of the models of supervisory convergence as described in the previous chapter.

5.1 ESMA: an overview of a powerful agency

In order to discuss supervisory convergence on capital markets, it is important to discuss the work of ESMA including its tasks, and the powers it has to fulfil these tasks. This allows for further comparison in the next chapters as to how the CMU project might influence this.

5.1 Objective and Tasks

Article 1(5) of the ESMA Regulation lists ESMA's overarching objective to: "*protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses*."[178] This objective is then broken down into six specified sub-objectives that arguably all relate underpin the importance of supervisory convergence: 1. Improving the functioning of the internal market, including in particular a sound, effective and consistent level of regulation and supervision; 2. Ensuring the integrity, transparency, efficiency and orderly functioning of financial markets 3. Strengthening international supervisory coordination, 4. Preventing regulatory arbitrage and promoting equal conditions of competition; 5. Ensuring the taking of investment and other risks are appropriately regulated and supervised; and 6. Enhancing customer protection. An emphasis lies hence in the steering and coordination of supervision, in order to safeguard the integrity and safety of the capital markets.

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[178] Regulation (EU) No 1095/2010 Of The European Parliament and Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC. G. Deipenbrock, 'The European Securities and Markets Authority and Its Regulatory Mission: A Plea for Steering a Middle Course', in: M. Andenas & G. Deipenbrock (eds.), *Regulating and Supervising European Financial Markets*, Cham: Springer International Publishing 2016. P. 17

The more specific tasks and powers of ESMA are set out in Art. 8 and Art. 9 of the ESMA Regulation. Under Art. 8(1) and Art. 9 of the ESMA Regulation seventeen tasks are set out for the agency.[179] These come largely down to the unification of regulation, promoting supervisory convergence, the monitoring of systemic risk, the collection and distribution of market information, the protection of stakeholders and tasks related to financial activities.[180]

5.2 Powers

ESMA is endowed with extensive powers to accomplish the outlined tasks, and has been referred to as the most powerful EU agency.[181] Its powers can be divided into three separate categories: regulatory powers, decision-making powers and direct supervisory powers.[182] Its powers were briefly mentioned under 2.3.1 in the general discussion on the ESAs powers, but will be more thoroughly analysed under this section.

5.2.1 Regulatory Powers

The regulatory powers of ESMA can be divided into the creation of draft legislation, and guidance through the creation of soft law measures.[183]

With the power of creating draft legislation ESMA is responsible for assisting the Commission in the creation of the Single Rulebook. It creates highly technical draft binding technical standards in the form of regulatory technical standards,[184] or implementing technical standards.[185] These drafts are then presented to the Commission, which can either accept or reject them partly, in an amended version or as a whole.[186] These measures are then formally adopted by the Commission under the procedure for delegated acts or implementing acts under Article 290 TFEU, or Article 291 TFEU.[187]

Other rulemaking powers can be found in ESMA's soft law regulatory powers through which it is meant to give guidance to market participants and NCAs in order to establish consistent, efficient

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[179] Article 8(1) mentions twelve general tasks, where Art. 9 (1) and Art. 9 (2) adds five specific tasks related to consumer protection.
[180] P. Weismann, *EU Agencies and Risk Governance in EU Financial Market Law*, Oxon: Routledge 2016. Pp. 119-120.
[181] M. Scholten & M. Van Rijsbergen, 'The ESMA-Short Selling Case: Erecting a New Delegation Doctrine in the EU upon the Meroni-Romano Remnants', *Legal Issues of Economic Integration* 2014, Vol. 41, No. 4, pp. 389–406. P. 392.
[182] Van Rijsbergen 2014. P. 120.
[183] Moloney 2011a. P. 64.
[184] Art. 10 ESMA Regulation.
[185] Art. 15 ESMA Regulation.
[186] Van Rijsbergen 2014. P. 120. For an extensive description of the procedure to adopt binding technical standards see also: Weismann 2016. Pp. 122-132.
[187] Di Noia & Gargantini 2015. P. 141.

and effective supervisory practices. On the basis of Article 16 ESMA Regulation, this can include guidelines or recommendations addressed to market participants.[188] These guidelines or recommendations are not legally binding, giving them a 'soft law' nature.[189] Noteworthy is that the Commission is not required to approve the guidelines or recommendations addressed to NCAs to foster consistent and effective supervision, giving ESMA a high degree of independence.[190] The nature of these guidance powers is somewhat controversial because these powers have a quasi-binding effect in practice.[191] This is because addressees of such guidance are required to make every effort to comply ESMA's guidelines and recommendations.[192] If they fail to do so, they are required to explain their non-compliance, which will be publicly disclosed. Hence this 'comply or explain' mechanism works on a strong naming and shaming basis.[193] It is therefore argued that these measures fall somewhere in between 'soft' and 'hard law', for which a stronger legal basis could be necessary.[194] Further criticism regarding these far-reaching powers deals with the fact that these soft law instruments are not adequately accompanied by procedural safeguards, including the lack of adequate legal remedies.[195]

5.2.2 Decision-making powers

ESMA furthermore possesses three different powers in which it can take direct decisions (aside from its tasks as direct supervisor, see 5.2.3). As supervision, inevitably will include decision-making, these powers are difficult to categorize. Some authors consider these powers as part of ESMA's supervisory powers,[196] whereas others consider these powers separately as decision-making powers.[197] Firstly, ESMA may decide to start an investigation when a NCA has not or incorrectly applied EU law.[198] In the case where ESMA detects a breach of EU law, it can take decisions in the form of recommendations on how a NCA can remedy such a breach. If it fails to do so, the Commission can issue formal opinions or even ultimately start an infringement procedure.[199] Secondly, ESMA may take decisions towards NCAs in case of emergency

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[188] Busuioc 2013. P. 118.
[189] Van Rijsbergen 2014. Pp. 120 - 121.
[190] R. Van Gestel & T. Van Golen, 'Enforcement by the New European Supervisory Agencies: Quis custodiet Ipsos Custodes?', in: K. Purnhagen & P. Rott (eds.), *Varieties of European Economic Law and Regulation: Liber Amicorum for Hans Micklitz,* Cham: Springer 2014. P. 766.
[191] Moloney 2011. P. 65.
[192] Art. 16 ESMA Regulation.
[193] Di Noia & Gargantini 2015. Pp. 150-151.
[194] Van Gestel & van Golen 2014.
[195] Chiti 2013. Pp. 103-104.
[196] N. Moloney, *EU Securities and Financial Markets Regulation*, Oxford: Oxford University Press 2014. Pp. 976-980. G. Bianco, 'Strenghts and Weaknesses of the ESMA-SEC Supervisory Cooperation', in: M. Andenas & G. Deipenbrock (eds.), *Regulating and Supervising European Financial Markets*, Cham: Springer International Publishing 2016. P. 172.
[197] Scholten & Van Rijsbergen 2014. P. 392. Weismann 2016. P. 133.
[198] Article 17 ESMA Regulation.
[199] Weismann 2016. Pp. 133-137.

situations where the orderly functioning of markets is at stake.[200] In cases where there is a real risk of the financial stability being jeopardized, ESMA can then take on a coordinating role instructing the NCAs. Lastly, ESMA can play a role in the settlement of disagreements between NCAs in cross border situations by providing a mediation role.[201]

5.2.3 Supervisory Powers

ESMA is further endowed with certain important supervisory powers. These can be distinguished into indirect and direct supervision. Amongst the indirect supervisory powers, belongs the power for ESMA to participate in colleges of supervisors,[202] cooperate with the ESRB in monitoring systemic risk,[203] promote a common supervisory culture,[204] conduct peer reviews,[205] directly assess the developments of capital markets,[206] and collect information from NCAs that is necessary to fulfil its duties.[207] The indirect aspect lies in the fact that ESMA does not directly supervise market participants. However, through these powers ESMA can monitor, and exert a strong influence on the NCAs and market participants. An example is of this is ESMA's ability to participate in supervisory colleges. Such supervisory colleges form institutionalised, but flexible structures for competent authorities to coordinate supervisory activities.[208] Whilst this form of decision-making does not allow the agency to directly issue decisions to market participants, it allows the agency to influence decision-making on significant platforms.[209] However, it ought to be clear that these supervisory powers are indirect due to the reliance of ESMA on the cooperation of national authorities, or other actors that hold seats in supervisory colleges.

The combination of supervisory powers, with decision-making powers gives ESMA teeth to bite with. An example of this is that ESMA can assess the resilience of market participants and the overall market in cooperation with the ESRB,[210] and should emergency situations become apparent, ESMA is able coordinate actions of NCAs, and issue decisions to the NCAs requiring them to address the situation.

What is unique for an agency amongst the ESAs, is that ESMA on the basis of secondary

[200] Article 18 ESMA Regulation.
[201] Article 19 ESMA Regulation.
[202] Article 21 ESMA Regulation.
[203] Articles 22-27 ESMA Regulation.
[204] Article 29 ESMA Regulation.
[205] Article 30 ESMA Regulation.
[206] Article 32 ESMA Regulation.
[207] Article 35 ESMA Regulation.
[208] Weismann 2016. P. 171.
[209] E. J. Pan, 'Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks', *Chicago Journal of International Law* 2010, Vol. 11, No. 1, pp. 243-284. P. 279.
[210] Art. 32 ESMA Regulation.

legislation has exclusive and direct supervisory competence in reviewing the work of credit rating agencies ('CRAs') and trade repositories. The powers of ESMA in regard to the former are codified in the CRA Regulation, and in regard to the latter in the European Markets and Infrastructure Regulation ('EMIR').[211] The supervisory powers granted to ESMA in the performance of these tasks must be considered as substantial. They include the exclusive right in registering CRAs and trade repositories,[212] the right to request information,[213] conduct on site inspections,[214] impose fines,[215] enforce penalties or withdraw registrations.[216] Before imposition of possible fines, ESMA allows for the hearing of the persons concerned,[217] and afterward fines imposed by ESMA are open to review of the CJEU.[218]

The relevant CRA Regulation and EMIR contain special provisions on how this direct supervisory position shapes the relationship with NCAs. In regard to both CRAs, and trade repositories the Commission has the ability to delegate certain tasks to NCAs if this is necessary for the proper performance of the supervisory task, under which the NCA would have the same supervisory powers as ESMA.[219] ESMA would need to set out specific conditions for the scope and duration of the delegation, and need to reimburse the relevant authority for any costs made.[220] Additionally, ESMA and the NCAs are bound by the mutual obligation to exchange information continuously when this is necessary for the carrying out of duties,[221] in order to strengthen the mutual duties of assistance and cooperation.[222] This obligation to cooperate is explicitly codified in the CRA Regulation in the form of Art. 26, but in EMIR only as consideration 50 EMIR.

Furthermore, ESMA may even go so far to suspend trading activities in markets. Whilst the other ESAs have a similar power laid down in their founding regulation, ESMA distinguishes itself still from its sibling authorities. The power of the ESAs to intervene on the market is restricted by Article 18 of each ESA regulation in which the conditions for intervention are laid down. The most important of which is the presence of an emergency situation, as defined by the Council.[223] However, in the case of ESMA additional secondary legislation has empowered the agency to

[211] Following the amendments introduced by Regulation (EU) No 513/2011 of the European Parliament and of the Council to Regulation (EC) No 1060/2009 Of the European Parliament and the Council of 16 September 2009 on credit rating agencies (CRA Regulation). Title VI of EMIR.
[212] Arts. 14-15 CRA Regulation, Art. 55 EMIR.
[213] Art. 23b CRA Regulation. Art. 61 EMIR.
[214] Art. 23d CRA Regulation. Art. 63 EMIR.
[215] Art. 23e CRA Regulation. Arts. 65-66 EMIR.
[216] Arts. 20, 24 CRA Regulation Art. 86 EMIR.
[217] Art. 25, 36c CRA Regulation, Art. 67 EMIR.
[218] Art. 263 TFEU. Art. 36e CRA Regulation, Art. 69 EMIR.
[219] Art. 30(1) CRA Regulation, Art. 74(1) EMIR.
[220] Art. 30(2) & (3) CRA Regulation, 74 (2) & (3) EMIR.
[221] Art. 27 CRA Regulation. Art. 84 EMIR.
[222] Consideration 54 EMIR.
[223] See for example Article 18(2) ESMA Regulation or Article 18(2) EBA Regulation.

intervene on markets or even coordinate on-site inspections in particular in cross-border situations.[224]

In contrast to the other ESAs, ESMA can also use its supervisory powers to raise its own finances. It can charge these market participants supervisory fees for tasks performed by ESMA.[225] This solidifies ESMA's budgetary independence from the Commission. Moloney observes that the direct supervision of these market actors only covers a small scope of all capital market participants.[226] Whilst this observation was made prior to when ESMA became responsible for trade repositories, it can be argued that this is still valid. In total ESMA supervises seven trade repositories,[227] and 39 CRAs in the European market (twelve more than at the time of Moloney's observation).[228] The day-to-day supervision of other financial institutions remains with the NCAs of Member States. Depending on the applicable regime to different actors on European capital markets, different obligations can apply for these NCAs and market participants. For example the MiFID provisions are applicable to investment firms, unless such firms qualify as an Undertaking for Collective Investment in Transferable Securities ('UCITS') or an Alternative Investment Fund Manager ('AIFM'). In such cases the UCITS legislation, or the AIFM Directive can be applicable. Under this legislation, the day-to-day supervision remains with the NCAs but they can still have important duties towards ESMA in certain scenarios such as notifying, seeking mediation, allowing ESMA to coordinate supervisory functions.

5.3 The ESMA Shortselling Case: A confirmation of ESMA's powers

The fact that ESMA has these far-reaching powers has not been met without scrutiny. The incremental expansion of ESMA's mandate and competences led to the UK starting an action for annulment before the CJEU, ex Article 263 TFEU. This case provided not only an important doctrine for EU constitutional law in general, but laid down a clarification on the expansion of ESMA's competences, relevant to this chapter. I shall start by discussing the relevant Meroni Doctrine that governed the powers of agencies prior to this case. Secondly, I shall the Shortselling case and its facts and legal proceedings in the following paragraph. Lastly, I shall

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[224] Examples are in cases of short selling, Art. 31 of the Short Selling Regulation (Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps) or Arts. 21 and 25 of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ('EMIR'). Other secondary legislation such as the MiFID II package has provided further supervisory powers such as the possibility to ban certain financial products trading (Title VII MiFIR).
[225] Art. 19 CRA Regulation. Art. 72 EMIR.
[226] Moloney 2011c. P. 196.
[227] ESMA, *List of registered trade repositories*, 2017a. Available at: https://www.esma.europa.eu/supervision/trade-repositories/list-registered-trade-repositories.
[228] ESMA, *List of Credit Rating Agencies*, 2017b. Available at: https://www.esma.europa.eu/supervision/credit-rating-agencies/risk.

evaluate the legal doctrine arising from this case and its effect on ESMA as an agency.

5.3.1 The Meroni Doctrine and the Romano Doctrine

Prior to the ESMA Shortselling Case, the limitations on the powers of EU agencies were governed by the Meroni doctrine and the Romano doctrine.[229]

The Meroni Doctrine

The Meroni case law from 1958 concerned the delegation of powers by the High Authority of the European Coal and Steel Community ('ECSC') to a private entity.[230] The Court determined that only clearly defined executive powers could be delegated. It considered that that delegated powers had to be clearly defined and a wide measure of discretion to the receiving party was not allowed, as it involved the actual transfer of responsibility.[231] In this way, the Court distinguished between executive powers and discretionary powers. It also considered of importance that the High Authority of the ECSC had delegated its powers in this case to a private entity.[232]

Chamon extracts six important principles that follow from this case in regard to delegating powers: 1. The delegating party or institution may not delegate more competences or wider competences that it has itself; 2. The party that receives the delegated competences ought to be adequately and effectively supervised by the delegating institution; 3. Judicial supervision and safeguards should be ensured continuously; 4. The institutional balance between the relevant EU institutions may not be disturbed; 5. The delegation should be necessary to achieve the tasks it pursues; 6. Delegation must take place explicitly.[233]

The Romano Doctrine

In this case concerning a preliminary ruling from the Belgian Labour Tribunal, the question arose if the Council could have delegated the power to take measures that had the force of law to an Administrative Commission.[234] At first glance, it appears as if the Romano case contains a straightforward rule of law. The Court answered this question in the negative. An important element was that the Treaties at that time did not provide for possible delegation to EU agencies,

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[229] M. Everson & E. Vos, 'European Agencies: What about the Institutional Balance?', *Maastricht Working Papers Faculty of Law* 2014, No. 4. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2467469.
[230] Case 9-56, *Meroni & Co., Industrie Metallurgiche, SpA v. High Authority of the Europan Coal and Steel Community* [1958], ECLI:EU:C:1958:7.
[231] Ibid. P. 152, pp. 154-155.
[232] Ibid. P. 152.
[233] M. Chamon, 'The Empowerment of Agencies under the Meroni Doctrine and art.114 TFEU: Comment on United Kingdom v Parliament and Council (Short-selling) and the Proposed Single Resolution Mechanism', *European Law Review* 2014, Vol. 20, No.3, pp. 380-403.
[234] Case 98/80, *Romano v Institut national d'assurance maladie-invalidité* [1981], ECLI:EU:C:1981:104.

or the judicial system that the Court referred to did not provide the possibility of review by the EU judiciary for delegated acts.[235] Prior to the Treaty of Lisbon there was no explicit judicial review arranged in primary law for agencies, and it was hence important for the CJEU to guarantee this explicitly in its case law.[236] Nonetheless, the rules that follow from both doctrines appeared to be clear cut.

5.3.2 The ESMA Shortselling Case

The UK sought the annulment of Article 28 of Regulation No. 236/2012 on short selling and certain aspects of credit default swaps ('the Shortselling Regulation').[237] This provision of the Shortselling Regulation gives ESMA the aforementioned powers to intervene in the market of net short selling positions.[238] The UK presented different arguments that considered that the delegation of wide discretionary measures to ESMA, as an agency, was illegitimate in light of the principle from the Meroni doctrine.[239] These arguments predominantly focused on ESMA's wide discretionary powers to identify a situation where there was a 'threat' in the financial markets, and to consequentially choose the measure that ESMA regarded as the most appropriate to intervene.

The Court, however, does not follow the arguments from the UK in the Shortselling case. The Court first observes that ESMA is not an entity of private law, as in Meroni.[240] Secondly, the Court states that the powers of the Shortselling Regulation are within the confines of the ESMA founding regulation and therefore cannot be considered autonomous.[241] Thirdly, the Court dedicates several of the paragraphs of the judgement to its considerations why ESMA's powers are circumscribed by criteria that limit ESMA's discretion. The Court considers for example that the powers to intervene as laid down in Art. 28(1) Shortselling Regulation, are only possible to invoke when the conditions from Arts. 28(2) and (3) Shortselling Regulation are met, as well as the further criteria of Art. 9(5) ESMA Regulation.[242] Additionally, the consultation requirements of ESMA towards the ESRB and NCAs, as well as the temporary character of ESMA's

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[235] Ibid. Para. 20. Scholten & Van Rijsbergen, 2014. P. 395.
[236] C. Di Noia & M. Gargantini, 'Unleashing the European Securities and Markets Authority: Governance and Accountability After the ECJ Decision on the Short Selling Regulation (Case C-270/12)', *European Business Organization Law Review* 2014, Vol. 15, No. 1, pp. 1-57. P. 33.
[237] Case C-270/12, *United Kingdom v European Parliament and Council of the European Union* [2013], EU:C:2014:18 ('Shortselling Case'). Para. 1.
[238] Article 28 Shortselling Regulatio specifically allows ESMA to oblige market participants with net short positions to notify NCAs or to publish their short positions. Additionally ESMA can prohibit or impose conditions on the entry by market participants into a net short position or short selling transactions.
[239] Shortselling Case. Paras. 28-34.
[240] Ibid. Para. 43.
[241] Ibid. Para. 44.
[242] Shortselling Case. Paras. 45-49.

intervention measures, provide extra procedural safeguards.[243] This leads the Court to conclude that: *'[…] the powers available to ESMA under Article 28 of Regulation No 236/2012 are precisely delineated and amenable to judicial review […]. Accordingly, those powers comply with the requirements* [stipulated in the Meroni case-law].'

The UK's second plea for annulment saw to the application of the Romano doctrine to Art. 28 of the Shortselling Regulation. It argued that this provision gave ESMA the power to adopt quasi-legislative measures of general application, contrary to the Romano principle.[244] The UK stipulated that a ban on short sale products related to an entire group of people, and not an individual decision, which hence gave the quality of a measure of general application having the force of law.[245]

The Court however gives a new reading to the Romano case law by stating that the "*institutional framework established by the [TFEU], in particular the first paragraph of Art. 263 and Art. 277 TFEU, expressly permits Union bodies, offices and agencies to adopt acts of general application.*"[246] Therefore, whilst Art. 28 of the Shortselling Regulation does have the character of a measure of general application, the Treaties, nor the Romano doctrine, do not preclude such delegation to ESMA as an agency, as long as delegation occurs within boundaries set by the Meroni doctrine.[247]

5.3.3 Significance of the ESMA Shortselling Doctrine

Whilst the Court confirmed that Meroni is still valid as a doctrine,[248] it did recognize the altered institutional framework since this decision. Under the new institutional framework EU agencies have found their rightful position in the Treaties, accompanied by the appropriate scrutiny. It seems that to the Court the powers of ESMA are acceptable; due to heavily circumscribed conditions they have to operate in. However, the Court has let the distinction between executive and discretionary powers become a grey area. As Scholten & Van Rijsbergen point out, the Court did recognize that ESMA as an agency possesses delegated discretionary powers by stating that Art. 28 of the Shortselling Regulation is an article that is accompanied by conditions that constrain the agency's "discretion".[249] Therefore the Court confirms the discretionary nature of ESMA's powers. In this regard it did not give ESMA a carte blanche to operate freely, seeing as emphasis was still put on the need for check and balances, including through judicial review.

[243] Ibid. Para. 50.
[244] Ibid. Para. 56.
[245] Ibid. Para. 57.
[246] Ibid. Para. 65.
[247] Ibid. Paras. 66-67.
[248] Ibid. Paras. 45-53. Di Noia & Gargantini 2014. P. 35.
[249] Scholten & Van Rijsbergen 2014. P. 394.

However, the ESMA Shortselling-case did affirm that ESMA's discretionary powers were in line with the treaties, and that its rulemaking powers were legitimate. This has allowed a way forward under which ESMA has been able to pursue its mandate through its far-reaching powers. Additionally, I would argue that the Shortselling case has allowed for an incremental increase in ESMA's mandate, where slowly new objectives and tasks have gradually been assumed by the agency. A good example is the introduction of EMIR. One year after ESMA became responsible for CRA supervision, this cornerstone of European derivative legislation added the direct supervision of trade repositories to ESMA's tasks. Additionally, after the Shortselling case deemed ESMA's intervention powers to be compatible with primary law, we may observe that the introduction of the new MiFID II legislation package contained similar intervention power only half a year after the ESMA Shortselling case was brought forward. The case therefore provided an important legitimization for ESMA's work in supervisory convergence. The recognition of its discretionary powers even allowed it to engage in a more direct supervisory role. Indeed the case, has contributed to allowing the agency to exercise roles of a discretionary capacity, even as a direct supervisor of different institutions.

5.4 ESMA: an assessment

Whilst ESMA is tasked with promoting supervisory convergence, its institutional framework does not fall squarely within the network, nor does it fit with centralized supervisor model. Whilst the Larosière Report argued for a decentralized system of day-to-day supervision,[250] the final result is an institutional model where the network of NCAs still implements the majority of day-to-day supervisory tasks, but ESMA is still enabled to steer them onto a convergent path as a centralized authority.[251] Its powers are so far-reaching that they cannot be deemed as 'merely' soft law.[252] Hence, ESMA allows itself to be categorized as a decentralized network agency, but with considerable centralized aspects that allow it to steer the NCAs. What distinguishes ESMA from its fellow ESAs, is that it can engage in direct supervision of certain specific market participants. This direct supervision allows for imposition of the same rules in the same manner of all CRAs and trade repositories. Hence, it appears that ESMA forms a more hybrid model of supervisory convergence between these two extremes as it makes use of both supervisory convergence models. Indeed the ability of ESMA to issue binding decisions or settle disputes between members of its network, and engage in direct supervision, make ESMA a unique model as an international financial regulator in the global financial system.[253]

[250] De Larosière 2009. Pp. 38-39.
[251] N. Moloney, 'Institutional Governance and Capital Markets Union: Incrementalism or a Big Bang', *European Company and Financial Law Review* 2016, Vol. 13, No. 2, pp. 376 - 423.
[252] Busuioc 2013. P. 124. Deipenbrock 2016. P. 25. Van Rijsbergen 2014. P. 120.
[253] Pan 2010. P. 281.

I would argue that within the spectrum of the two models, despite its direct supervision over CRA's and trade repositories, ESMA leans more to the network model. In fact over the first years, ESMA has focused predominantly on issuing a great body of binding technical standards in order to complement the Single Rulebook.[254] Hence, it played a modest role in promoting supervisory convergence as a centralized authority within the network. Yet in contrast to its predecessor the CESR, ESMA's powers to foster supervisory convergence have genuinely expanded, hardened and carry real weight.[255]

The ESMA Shortselling case has been instrumental in confirming ESMA's powers and competences, grounding its powers regarding supervisory convergence on a firm foundation. This foundation has allowed the agency to build upon its mandate and further progress its tasks, also in the field of supervisory convergence. In particular the confirmation of the legitimacy of ESMA's discretionary powers has been instrumental in allowing it to engage in a more direct manner of supervision. This in turn has provided the agency with certain

[254] ESMA 2015, *Annual Report 2015*. ESMA/2016/960, 2016c. Pp. 53-55.
[255] Moloney 2011c. P. 184.

‘The law? The law is a human institution!’
- Ethan Coen, *O Brother, Where Art Thou?*

6. Current Supervisory Convergence in CMU or long term reform

Rece1ntly a shift in EU supervisory policy can be observed. As the completion of the Single Rulebook of capital market rules and standards draws to a close, greater emphasis is put on stronger enforcement of these rules.[256] Such a development towards a more supervisory dimension was deemed necessary as differences in the application of these rules still persist across different Member States.[257] Furthermore, new supervisory tasks for NCAs arise from the Single Rulebook. The supervisory practices stemming from these new tasks are continuously developing and evolving, posing therefore a risk to ensuring convergence.[258] Hence, the Commission has made supervisory convergence an important pillar in its plans for the CMU.[259] I shall first describe how supervisory convergence achieves CMU’s objectives (6.1), after which I shall provide an overview of current measures being taken by ESMA (6.2) and what alternatives institutional reform can offer for the long term (6.3). This last part will include a discussion of both the options regarding a central supervisor or further centralization in the network.

6.1 Supervisory convergence a tool for achieving CMU’s objectives

Supervisory convergence is particularly well suited as a tool to accomplish some of the goals that the CMU aims to achieve. Not only is it a way to improve the overall stability of the financial system,[260] but it also plays an important role in deepening and integrating cross-border capital markets, as well as increasing competition.[261]

Firstly, the guarantee that the same standards will be applied across the Union ensures that regulatory arbitrage is limited. By striving for the same application of the same rules everywhere, Member States do not engage in a race to the bottom when it comes to enforcing the levels of supervision. Such a race might attract the establishment and investment of companies towards a specific national regime, but could put the pan-EU financial markets at risk. In this way, supervisory convergence enables more effective oversight, especially in regard to cross-border financial groups.[262] In this way, a uniform regime of supervision guarantees financial stability

[256] Moloney 2016b. Pp. 333-334.
[257] Busch 2016. P. 8.
[258] EBA 2016. P. 4.
[259] Commission 2015a. Pp. 21-22. Commission 2015b. Pp. 23-24.
[260] ECB 2015. P. 3.
[261] Commission 2015b. P. 2.
[262] EBA 2016. P. 3.

across the Union and ensures investor protection.[263]

Secondly, supervisory convergence also fulfils a function in market building. Different supervisory regimes or regulatory standards can form a barrier for a market actor to expand its activities across the border as such actors can be faced with legal uncertainty or they have to invest greatly in order to ensure compliance with these different regimes.[264] By promoting supervisory convergence, and ensuring the same standards, it becomes easier for market actors to engage in cross-border activities and a level playing field is created. An important outcome of supervisory convergence is therefore the removal of cross border obstacles to capital markets, hence integrating national markets to a pan-EU wide capital market. This makes supervisory convergence a 'pivotal' concept in guaranteeing the free movement of capital.[265]

Thirdly, and inextricably linked to this concept of promoting integration is the element of encouraging competition through supervisory convergence.[266] By eliminating cross border obstacles, and integrating national capital markets, supervisory convergence takes away barriers of entry to the capital markets. This should facilitate the process of increasing competition, as investment firms from one Member State are better able to enter different markets in other Member States across the EU.

Lastly, I wish to submit the observation that the promotion of supervisory convergence ensures the effectiveness of harmonization. As pointed out under 2.3.1, recently the wider financial markets have been met by a new wave of financial harmonization that aimed for a more conclusive, maximum approach to harmonization. Packages of legislative instruments were more dominant, and regulations were preferred over directives. However, seeing as administrative law is barely harmonized on a European level, the implementation and execution by supervisory authorities can differ greatly. NCAs are bound by their respective administrative frameworks, decision-making procedures and principles of administrative law. Whilst the substantive norms of regulations are still implemented, national administrative law might still leave discretion as to how this is implemented. Supervisory convergence hence gives real teeth to harmonization and contributes to ensuring an effective implementation of EU legislation.

In this way, supervisory convergence can prove to be a useful tool for the Commission to achieve its objectives in the building of a CMU. Despite recognizing that supervisory convergence is

[263] ESMA 2016b. P. 3.
[264] Commission 2015c. P. 15.
[265] Commission 2015b. P. 24.
[266] Commission 2017a. P. 12.

essential for the integration of financial markets, to ensure investor protection and safeguard financial stability,[267] the Commission has not opted for a single strategy on how to promote supervisory convergence. Instead, it seems to consider - and for now pursues - different methods. It currently relies on the implementation of supervisory convergence by ESMA, but is also open to long-term institutional reform.[268]

6.2 Ongoing Supervisory Convergence: ESMA as a driving force

ESMA and its mandate provide a convenient starting point and infrastructure for spearheading the goal of supervisory convergence.[269] Earlier on the European Parliament had criticized the work of the ESMA as being too focused on the completion of the Single Rulebook, through which responsibilities concerning the fostering of supervisory convergence were 'neglected'.[270] Indeed, combining its different tasks as both regulator and supervisor has proven to be challenging for the agency within an environment of institutional growth and changing organisational and operational demands.[271] However, currently ESMA has followed the trend of focusing no longer primarily on completing the Single Rulebook, but on the process of supervisory convergence instead.[272]

This trend can be observed in different ways. Firstly, the growing emphasis on enforcement can be deduced from the allocation of time and resources, as follows from Work Programmes of the agency. Where from 2011 to 2014 the emphasis still remained on the regulatory work of completing the Single Rulebook in the form of drafting implementing standards or guidelines,[273] from 2015 onwards the agency started to divert resources to the implementation of such regulation.[274] In 2014 ESMA still dedicated €7.510.000 dedicated to completing the Single

[267] Commission 2016a. P. 6.
[268] Commission 2016a. P. 10.
[269] Verón & Wolff 2016. P. 136.
[270] European Parliament, *Review of the New European System of Financial Supervision (ESFS), Part 1: The Work of the European Supervisory Authorities (EBA, EIOPA, and ESMA) - The ESFS's Micro-Prudential Pillar*, IP/A/ECON/ST/2012-23, 2013. P. 14.
[271] Deipenbrock 2016. P. 37.
[272] S. Maijoor. (2016), *'Keynote Address'*, Speech at PRIME Finance 6th Annual Conference, ESMA71-844457584-329, 23 January 2016. P. 4.
[273] In the Work Programmes from 2011-2014, ESMA has predominantly dedicated the majority of its objectives and intended actions to regulatory focuses and standard setting.
See: ESMA ESMA Work Programme for 2011 and implementation of CESR Work Programme for 2010, Available at:
https://www.esma.europa.eu/sites/default/files/library/2015/11/esma_workplan_and_budget_2011.pdf,
ESMA, *2012 Work Programme,* ESMA/2011/330 final, 2011. ESMA (2012), *SMSG 2013 Work Programme*, ESMA/2012/SMSG/54, 2012. ESMA, *2014 Work Programme*, - ESMA/2013/1355 rev., 2013. ESMA, *2015 Work Programme,* ESMA/2014/1200 rev., 2014.
[274] ESMA 2014. P. 7.

Rulebook, but only spent €2.850.000 to convergence of supervision.[275] In contrast, the ESMA 2017 Work Programme allowed a budget of €4.788.000 Euros for completing the Single Rulebook and a budget of €15.138.000 Euros for fostering supervisory convergence.[276]

Secondly, ESMA has started implementing specific strategies that are meant to encourage the fostering of supervisory convergence in the form of detailed work programmes. These programmes have as their goal to facilitate improved (internal) governance of the agency in the pursuit of supervisory convergence.[277] In 2016 ESMA adopted its first Supervisory Convergence Work Programme. In this programme it identified what areas needed particular focus of supervisory convergence, prioritising certain specific spheres of cross-border supervision.[278] Such a work method, allows a more structured approach, identifying both quick wins, and areas where supervisory convergence is more pressing.

A third way that ESMA has intensified its approach towards supervisory convergence is the tools it uses. ESMA has stated it will continue to carry out peer reviews, but in an intensified and more critical approach. This will focus more on "identifying, supporting and sharing good practices and effective supervisory techniques and enabling sufficient consistency of approaches to ensure that consistent outcomes can be achieved and internal market barriers reduced."[279] Hence, it is using its tools in a more critical and pressing manner, which would suggest an even further hardening of the ESMA soft law toolbox. Indeed ESMA's peer reviews have not shied away from criticizing actors in its network and becoming more "intensive, regular, and robust".[280]

6.3 Institutional Reform in CMU: Convergence towards centralization?

In its Green Paper on the CMU, the Commission recognized that the ESAs had an important role to play as institutions in the fostering of supervisory convergence, by assessing assess if the powers of the ESAs under the current institutional framework would be adequate to achieve convergence of supervisory standards.[281] This opened the discussion on long-term (institutional) reforms in order to promote supervisory convergence within CMU.

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[275] ESMA 2013. Pp. 6-18.
[276] ESMA 2016a. Pp. 8-23.
[277] ESMA 2016b. P. 10.
[278] ESMA 2016b. P. 3.
[279] ESMA, *ESMA response to the Commission Green Paper on Building a Capital Markets Union*, ESMA/2015856, 2015b. P. 6.
[280] Moloney 2016c. P. 418. Moloney specifically highlights the peer review concerning best execution requirements (ESMA/2015/494) and recent peer reviews in the field of short selling towards unnamed NCAs.
[281] Commission 2015a. Pp. 22, 26.

6.3.1 A central supervisor?

The President of the Commission has spoken out in favour of more centralization of governance within capital markets, in order to finally reach a true and genuine EMU.[282] Also the ECB has advocated for a centralized model with a single supervisor for capital markets.[283] However, neither of these two actors mentioned explicitly if this role would be given to one of the ESAs (presumably ESMA), or if it saw this role within the competences of the ECB or a different institution. ESMA itself has underlined that it did not seek to assume such a role, but is prepared to take it upon itself should it be accompanied by adequate resources.[284] Due to its experience and mandate, ESMA is particularly well placed in the financial infrastructure to take on such a role.[285] A model of a centralized capital markets supervisor, directly supervising CMU, is not entirely unlikely.[286] This would then lead to a twin peaks model of supervision across the Eurozone, with the ECB being competent for prudential supervision under the SSM, and an ESMA-like authority being responsible for EU wide conduct supervision. However, such a model would not be easy to implement. I shall briefly outline the legal limitations and the political obstacles for policymakers.

A central supervisor model would firstly sit ill at ease with the principle of subsidiarity as codified in Art. 5(3) Treaty on the EU ('TEU'). Following this provision "*the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, [...] but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level*." Where a case for the SSM in the Banking Union could be made following the series of European banking crises, this argument would not be so strong for a capital market wide supervisor. Arguably, a great deal of improvement can still be accomplished through further coordination between Member States.[287] However, the direct supervision of CRA's and trade repositories by ESMA demonstrates that direct supervision of specific entities is a viable option and cannot be ruled out.

Whilst an institution such as ESMA appears well placed to assume the role of a central supervisor, attribution of further powers to this agency is limited by the earlier mentioned *Meroni* doctrine of the CJEU. Even though the ESMA Short Selling case nuanced this by indirectly stating that discretion is allowed as long as it is circumscribed by various conditions and criteria

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[282] Juncker 2015.
[283] ECB 2015.
[284] ESMA 2015b. P. 5.
[285] Verón & Wolff 2016. Pp. 147-148. Moloney 2016a. P. 472.
[286] Moloney 2016a. P. 474.
[287] ESMA, *Supervisory Convergence Work Programme 2017*, ESMA42-397158525-448, 2017c. P. 15.

that limit that discretion.[288] However, a role of ESMA as a central supervisor would entail a great deal of discretionary operational decisions that would be difficult to limit through conditions and criteria.[289] This would make ESMA's role as a supervisor either impossible due to the procedural constraints that would need to be put in place to limit this discretion, or would make any flexible framework unconstitutional.

Alternatively, the ECB qualifies as an institution, and not an agency, ex. Article 13 TEU. Hence, it is not faced with the same problem of delegation. However, it is faced with a different problem, where the Meroni doctrine prevents the delegation of the discretion that is necessary for effective supervision. A different problem in regard to the ECB lies however in finding the appropriate legal basis. In the case of the SSM this was circumvented. The legal basis for conferring supervisory activities upon the ECB under the SSM is Article 127(6) TFEU, which explicitly mentions the 'prudential supervision of credit institutions'. This is problematic seeing as capital market supervision is predominantly focused on conduct supervision of financial institutions.[290] Despite its function as legal basis for the SSM, Article 127(6) TFEU can therefore not serve as a legal basis for the ECB to assume a role as central supervisor on capital markets.

This leaves a different, but unlikely option to create an entirely new central single supervisor. On the basis of Article 352 TFEU the Council is able to create a new central supervisor. However this would need to be done on the basis of unanimity, with consent of the European Parliament. This would be a somewhat drastic new step, as the setup of a new institution could have large constitutional ramifications that would need to be regulated. It also stands at odds with the incremental way in which the CMU project has been pushed forward, and hence seems unlikely.

Lastly, the political context must be mentioned. As discussed above, a central model of supervisory convergence can be regarded as controversial as it tends to impede on the sovereignty of Member States. Whilst financial governance in the EU has proven to be a (unique) climate where Member States are willing to concede and compromise in creating supranational regulatory and supervisory structures,[291] centralization of supervision on capital markets has proven to be a sensitive. The UK has spoken out against such a model on multiple occasions.[292] However with the impending departure of the UK from the EU, a case can be made for

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[288] Case C-270/12, *United Kingdom of Great Britain and Northern Ireland v European Parliament and Council of the European Union*, ECLI:EU:C:2014:18. Paras. 44-45.
[289] Moloney 2016b. P. 314.
[290] Moloney 2016c. P. 400.
[291] Pan 2010. P. 279.
[292] Bank of England, *The Bank of England's Response to the European Commission Green Paper: Building a Capital Markets Union*, 2015a. P. 39. Bank of England, 'A European Capital Markets Union: implications for growth and stability', *Financial Stability Paper* 2015b, No. 33. P. 21.

centralization. Moloney argues that the previous blocking of financial integration by the UK will no longer be a problem, which might the CMU project an extra push forward.[293] ESMA Chairman Steven Maijoor follows this view, highlighting the increased necessity of the CMU. He emphasized the danger of regulatory competition: as financial institutions leave the UK, Member States might compete for their relocation by lowering supervisory standards.[294] Other authors such as Busch however point out that the current unstable climate of Euroscepticism across the Union delegitimizes the CMU project, which comes down to pushing integration in a time of nationalism.[295] He points out that if anti-European political powers will rise to power, centralization in such cases is unlikely. Since his publication in December 2016 however, I would argue that an opposite has taken place. Austrian, Dutch and French elections in 2017 did not play into Euroscepticism as expected, which has been referred to as 'the defeat of a populist spring'.[296]

6.3.2 Stronger centralization within the Network: Review of the ESAs

One of the biggest opportunities for institutional reform of the supervisory framework on the EU capital markets, lies in the review of the functioning of the ESAs. The Commission already announced that a reassessment of the governance and funding of the ESAs would be necessary to promote supervisory convergence within the CMU.[297] This assessment should result in a legislative proposal that would transform the review into reform.[298] For this occasion, the Commission had launched an open consultation on the powers of the ESAs. The De Larosière Report already emphasized the need to review the ESFS after three years.[299] Seeing as the last extensive review took place in August 2014,[300] the current timing allows for another general evaluation of the ESAs, as well as a specific evaluation aimed at the CMU. The general results of and responses to this consultation were published in a feedback statement at the end of June 2017. At the time of writing the legislative proposal that is to give shape to the reform of the ESAs is still expected for the end of 2017.[301]

An important expectation is that in the announced legislative proposal we will be able to ascertain a strengthening of the ESAs within their current network position. Several factors indicate this. In

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[293] Moloney 2016a.
[294] S. Maijoor, '*Review of the European Supervisory Authorities: Opportunities to ensure a safe and sound financial system*', Speech at the ALDE Seminar on the Review of the European Supervisory Authorities European Parliament, ESMA71-844457584-346, 8 February 2017. P. 4.
[295] Busch 2016. Pp. 3-4.
[296] G. M. M. L. Verhofstadt, '*Reaction to the State of the Union*', Speech at the European Parliament for the State of the Union 2017, 13 September 2017. Available at: http://alde.eu/en/news/968-no-place-for-alt-right-governments-in-eu-and-need-for-transnational-lists-guy-verhofstadt-in-sou/.
[297] Commission 2015a. P. 22. Commission 2015b. P. 27.
[298] Commission 2015b. Commission 2017a. P. 11.
[299] De Larosière 2009. P. 58.
[300] Commission 2014b.
[301] Commission 2017a. P. 19.

regard to supervision on the capital markets, the Commission stated clearly that its first priority is to "*strengthen the powers of ESMA to promote the effectiveness of consistent supervision across the EU and beyond*."[302] This process was started off initially by the Green Paper on the CMU, which already posed questions concerning the powers of ESMA, and if this was sufficient to achieve supervisory convergence. This shows that the review of the ESAs is inextricably linked with the CMU project. The follow up of this Green Paper was the initial Action Plan by the consultation on the ESAs that announced the White Paper on ESA's funding and governance. The initial deadline for this White Paper of mid 2016 was not met. Instead, the Commission completed its Open Consultation reviewing the governance and funding of the ESAs in May 2017. This provides the necessary input that will result in a legislative proposal that will be published at the end of 2017.[303] The ESA consultation is not binding, as questions are posed to for input towards policy making, but the Commission can use consensus among market participants to legitimize its policy agenda. By analyzing both the consultation document and the feedback statement that lists the reactions of respondents, this can provide an idea of what lies in store for the reform of the ESAs. In this regard many elements point at the continuation of further centralization of capital market supervision, towards a more hierarchical position for ESMA.

The consultation itself is divided in four parts: 1. Tasks and powers of the ESAs; 2. Governance; 3. Adapting the architecture to current challenges in the market; 4 Funding. Most attention in the review is given to the first point on the powers the ESAs. Out of the 32 questions in the consultation, 21 concern these powers and tasks. Under this point firstly, the existing duties for all ESAs are reviewed, including observations on the existing supervisory convergence toolkit. Secondly, the consultation assesses the prudential tasks of the ESAs. Lastly, and most importantly, the first part contains a section that concerns the direct supervisory powers of ESMA.

In its feedback statement on the consultation, the Commission summarizes the answers of all 227 respondents for each point. The most important elements from these answers will be discussed. The majority of the respondents answered questions regarding the supervisory convergence toolkit predominantly positively.[304] There is a strong appreciation of the mandate of the ESAs among most respondents. Some argue that the ESAs are still too limited in their tools and mandate, whilst some others state that the ESAs should have more attention for the limits of their

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[302] Commission, *Completing the Capital Markets Union: Building on the First Round of Achievements* (Press Release), IP/17/1529, 2017c.
[303] Commission 2017a. P. 19
[304] Commission, *Feedback statement on the public consultation on the operations of the European Supervisory Authorities*, 2017d. Available at: https://ec.europa.eu/info/consultations/finance-2017-esas-operations_en. P. 5.

competences, and respect the NCA's margin of discretion.[305] However the majority again supports a more dominant role for the ESAs in promoting supervisory convergence, especially recognizing this need in light of the CMU.[306] The feedback statement does not provide for statistics as to the precise division of support, but does highlight that some respondents even argued in favour of ESMA assuming the role of a central supervisor.[307] What most respondents agree on, is that at least further coordination between NCAs, but also between ESAs is necessary.

These responses are not conclusive, and do not form a guarantee that suggestions will be followed upon. However, it does provide the Commission with a legitimization to continue with the advancement of the supervisory convergence project, also in the further form of expanding ESMA's role in supervisory convergence within the CMU. It appears that ESMA itself does look favourably upon this. ESMA had already requested clarification and revision of its toolkit to achieve supervisory convergence in response to the first Green Paper that launched the CMU project.[308] ESMA requested for example that peer review results should be disclosed publicly without consent of the reviewed party. Additionally, ESMA argued that the power to instigate the breach of EU law procedure of Article 17 should be extended to cover all obligations of NCAs under EU directives. This would enable ESMA, according to the agency itself, to adequately pursue convergence across the entire financial regulatory field. ESMA reaffirms these requests in its response to the open consultation.[309] However, it additionally states that in regard to supervisory convergence measures, it sees a need to bring certain new areas in its scope of competences. The agency requests to bring International Financial Reporting Standards ('IFRS') into its mandate. The agency sees a strong risk for divergence here, and believes that it should be able to make use of all convergence tools here, including the breach of Union law.[310] Essentially such an expansion amounts to providing ESMA with a stronger hierarchical position over the NCAs in the network, as it can enforce and ensure compliance easier in the wider field.

In the discussion on the direct supervisory powers of ESMA, the Commission focuses on specific segments of capital markets. The Com mission recalls that since the Five Presidents Report a strong case has been made for centralization in capital markets. Additionally, the Commission observes that the impending Brexit requires more carefully arranged supervision, because this

[305] Commission 2017d. Pp. 5-6.
[306] Commission 2017d. P. 5.
[307] Commission 2017d. P. 5.
[308] ESMA 2015b. Pp. 18-19.
[309] ESMA, *ESMA response to the public consultation on the operations of the European Supervisory Authorities*, ESMA03-173-194, 2017d. Pp. 5, 7.
[310] ESMA 2017d. P. 5.

event might lead to turbulent and volatile markets.[311] Following this, the Commission argues that extending ESMA's direct supervisory powers can be beneficial for specific market actors where this is necessary, where this can make markets more efficient, or where financial stability concerns arise.[312] As possible examples it suggests that this could be possible for data providers under MiFID II, Pan-European investment fund schemes or central counter parties ('CCPs').[313]

According to the feedback statement, "a vast majority of respondents" has spoken out in favour of direct supervision of CCPs by ESMA.[314] Additionally, a majority views data providers as being suitable for direct supervision under ESMA.[315] However, a majority does not see a strong case for the pan-European investment industry. Remarkably is that cross-border investment funds, *do* see the benefits in this themselves. However, this is mainly the case for the entities that engage in cross-border services. ESMA itself has pointed out that it could envision such a role for itself in regard to Benchmarks, data providers under MiFID, third-country CCPs and possibly in the longer term all CCPs.[316] Not surprisingly, the ECB's response to the consultation is more moderate. It acknowledges the use of centralizing supervision in integrating capital markets for example by centralizing supervision in the field of pan-European investment fund-schemes such as AIFMs or UCITS, but is more hesitant when it comes to CCPs or Central Securities Depositories ('CSDs') due to their integration with the Eurosystem.[317] The ECB hence stresses that the Eurosystem must remain adequately involved in such transfers of supervision.

An important addition would furthermore be ESMA's increased funding in order to fulfil its mandate. The Chair of ESMA has suggested this can happen both through raising the maximum thresholds of fines it can impose, or by increasing levies in Member States.[318] Indeed such an expansion of ESMA's powers leads to further independence. Fostering such independence from NCAs and Member States, also allows ESMA to engage in stronger enforcement. This can arguably be considered to be an extra move towards further centralisation.[319]

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[311] Commission, *Consultation document: operations of the European Supervisory Authorities* (Public Consultation), 2017e. Available at: https://ec.europa.eu/info/sites/info/files/2017-esas-operations-consultation-document_en.pdf. P. 16.
[312] Commission 2017e. P. 17.
[313] Commission 2017e. P. 18.
[314] Commission 2017d. P. 13.
[315] Commission 2017d. P. 14.
[316] ESMA 2017d. Pp. 3-4.
[317] ECB, *Consultation on the operations of the European Supervisory Authorities,* 2017b. Available at: http://www.ecb.europa.eu/pub/pdf/other/ecb.consultation_on_operations_of_ESA_201707.en.pdf?293cf1575920e5a08e0b54165f961e62. Pp. 7-8.
[318] Maijoor 2017. Pp. 6-7. ESMA 2017d. P. 4.
[319] N. Verón, 'Defining Europe's Capital Markets', *Bruegel Policy Contribution Working Paper* 2014, No. 12. P. 3.

The review of the ESAs does not signal towards a dramatic institutional reform through the creation of a central supervisor for ESMA. However an incremental, step-by-step reform of the financial supervisory framework is not unlikely. The responses to the consultation support such an incremental reform, and do not preclude increasing both the scope of ESMA's direct supervisory powers to a new limited group. The CMU project is therefore likely to expand ESMA's scope of operation and methods of enforcement through such a reform in a White Paper, and ultimately this is likely to happen through amending the founding ESA regulations. These reforms would amount in a gradual move towards a more centralized authority in the current network approach of supervisory convergence. Already such a trend can be witnessed in ongoing institutional developments in the legislation that is brought forward under the CMU project. The next chapter will discuss the implications for the supervisory framework of these developments.

"There's a kind of rough path trod down through the forest, but improved here and there with a few flat rocks laid down like stepping stones. Maybe Oshima's brother worked on the path little by little each time he stayed here. [..] .Like someone excitedly relating a story only to find the words petering out, the path gets narrower the farther I go."

– Haruki Murakami, *Kafka on the Shore*

7. Observations of current institutional developments

As the CMU agenda strives to obtain its objectives of market building, it has brought forward several different legislative projects. Some of these have already resulted in legislation, whereas other proposals are still in various different stages in the pipeline. These documents can see either to the regulation of new areas of capital market law, or provide a revision of existing legislation. Often this legislation will contain a number of provisions that relate to the governance of the supervision or enforcement of the legislation. In the following section I will examine the developments regarding supervisory arrangements in three pieces of legislation that have brought forward recently by the Commission in the context of CMU. The first is the Prospectus Regulation, which has been published in the Official Journal of the EU, and has entered into force. The second document is the Securities Regulation that after long negotiations has settled into a final agreed text, but is still subject to a vote of the European Parliament and Council. The last analysis will consider two proposed revisions of EMIR, which are still in the original form of the Commission Proposals. The fact that these documents are in different stages of the legislative procedure can provide an insight into the attitude of the legislators to the topic of supervisory convergence, based on the amendments inserted throughout the legislative procedure. This last point is particularly relevant for the Securities Regulation.

7.1 The Prospectus Regulation

Directive 2010/73/EU ('the Prospectus Directive') set rules that allowed private parties to attract investment on public markets through a public offer. In particular the initial directive contained different rules on the levels of disclosure rules that had to be met by companies issuing shares or debt. In this way, investors from different jurisdictions were guaranteed an equivalent level of protection.[320] When such a prospectus is approved by an NCA, the company in question would be able to issue shares, debt or derivatives in all other Member States.[321]

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[320] Commission, *The Commission proposes to overhaul prospectus rules to improve access to finance for companies and simplify information for investors* (Press Release), IP/15/6196, 2015d. P. 1. Consideration 1 of the Prospectus Regulation.
[321] Commission 2015d. P. 2.

7.1.1 Revision of the Prospectus Directive

The revision of the Prospectus Directive was one of the first policy steps taken in the name of the CMU project.[322] It can be considered even a symbolic step, seeing as the very first steps of European capital market harmonization consisted of directives governing public listings.[323]

The Explanatory Memorandum of the Commission Proposal for the Prospectus Regulation emphasized that the requirement to present such information must not form an unnecessary obstacle form companies to access such public markets.[324] Following as such, the new Prospectus Regulation seeks to accomplish three primary goals: 1. reducing the administrative burden of drawing up of prospectus for all issuers, in particular for SMEs, frequent issuers of securities and secondary issuances; 2. making the prospectus a more relevant disclosure tool for potential investors, especially in SMEs; and 3. achieving more convergence between the EU prospectus and other EU disclosure rules.[325] In this capacity it fits in with the objectives of CMU to fight against fragmentation in financial markets through harmonizing, diversifying financing sources by making it easier to enter public markets and strengthening cross border capital flows by ensuring the same levels of protection.[326]

Regulation 2017/112 ('the Prospectus Regulation') was adopted by the European Parliament and the Council on the 14th of June, and entered into force on the 20th of July.[327] Different parts of the regulation will gradually become applicable over the ensuing period. For example, as of the 20th of July 2017, new exemptions to the Prospectus obligation apply where such a disclosure document no longer needs to be published. This is the case for "*securities fungible with securities already admitted to trading on the same regulated market, provided that they represent, over a period of 12 months, less than 20 % of the number of securities already admitted to trading on*

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322 Commission, *Revamping the prospectus, the gateway to European capital markets* (Fact Sheet), MEMO/15/6198, 2015e.

323 These first steps were the Listings Particulars Directive (Dir. 80/390, Council Directive coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, O.J. 1980/L 100/1), and later the Public Offer Directive (Dir. 89/298, Council Directive coordinating the requirements for the drawing up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, O.J. 1989, L 124). See also: M.G. Warren, 'The Common Market Prospectus', *Common Market Law Review* 1989, Vol. 26, No. 4, pp. 687-716.

324 Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading ('Prospectus Regulation Proposal'.

325 Prospectus Regulation Proposal.

326 Prospectus Regulation Proposal.

327 Regulation (EU) 2017/112 of the European Parliament and Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

the same regulated market".[328] In the preceding directive this threshold was set at 10%. A further example as of the 21st of July 2017 is that no prospectus is needed when it concerns "*an offer of securities to the public with a total consideration in the Union of less than EUR 1 000 000, which shall be calculated over a period of 12 months.*"[329] This intends to alleviate the disclosure obligation on SMEs or institutions that issue securities on a repetitive basis and facilitate access to capital markets.

7.1.2 Changes regarding Supervisory Convergence

Whilst the exemptions to the prospectus obligation are set to have a big impact on the private sector,[330] one can also observe that the revision has an impact on the regime for supervisory convergence.

Due to the fact that the majority of issued prospectuses came from only a handful of countries, this suggested that issuers could be targeting compliant supervisory regimes, with Luxembourg, Ireland, the UK, France and Germany accounting for more than 60% of all issued prospectuses.[331] The Commission underlines in its European Stability and Financial Integration Review that the Prospectus regulation includes an increase in ESMA's powers in order to level out these differences.[332] However, such an increase in powers is not of such significance that the ESMA Regulation had to be amended in order for the agency to gain new competences. Instead, a more incremental shift towards more emphasis on ESMA's role in the prospectus regime can be noted. I observe four important ways that ESMA's role is expanded: 1. Through the explicit inclusion of supervisory convergence in the Regulation; 2. Through the provisions around the central registry; 3. New provisions around co-operation between ESMA and NCAs; 4. The numerous grounds on which ESMA can draft ITS or RTS.

Supervisory convergence explicitly included

Firstly, the Prospectus Regulation has explicitly included supervisory convergence in the remit ot the prospectus regime and attributed this task to ESMA as an agency. When the prospectus directive was amended in 2010 to replace the role of the CESR by ESMA, this version of the directive already mentioned in the considerations that the establishment of ESMA could lead to a

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328 Article 5(1), sub A Prospectus Regulation.
329 Article 1 (3) Prospectus Regulation.
330 Commission*, Impact assessment accompanying the original proposal for a regulation on prospectus – Executive summary* (Commission Staff Working Document), SWD/2015/0256 final, 2015f.
331 Commission, *European Financial Stability and Integration Review (EFSIR): A focus on Capital Markets Union* (Commission Staff Working Document), SWD(2016) 146 final, 2016c. P. 42.
332 Commission 2016c. P. 42.

more convergent approach in the scrutiny of prospectuses,[333] but did not provide the agency with any competence to effectively pursue to do so in any of the operative clauses.

The considerations in the revised Prospectus Regulation go further however. Consideration 60 of the Prospectus Regulation reads that ESMA "*should play a key role in fostering supervisory convergence by using its powers under Regulation (EU) No 1095/2010 [...]. In particular, ESMA should conduct peer reviews covering activities of the competent authorities under this Regulation within an appropriate time-frame*." In this manner, the considerations actually provide a reading where ESMA is enabled to engage in supervisory convergent practices, and make use of its capacities as outlined under its founding regulation. Additionally, the explicit emphasis on peer-reviews provides with a strong indicative tool in how the EU legislator envisions the pursuit of ESMA's activities in this regard. As already pointed out under Section 6.2, ESMA's peer reviews have become more rigid and thorough lately, making it a valuable tool. This consideration is even further expanded on in the substantive articles of the Regulation. More specifically, the power is reaffirmed in Article 20 (12) and (13) of the Prospectus Regulation. This article governs the approval process by NCAs of prospectuses. The first eleven sub-articles subject the prospectus to approval by the relevant NCAs and include different requirements for the approval process. Paragraph 12 of Article 20 requires ESMA to:

> "*use its powers under Regulation 2010/1095/EU to promote supervisory convergence with regard to the scrutiny and approval processes [of NCAs] when assessing the completeness, consistency and comprehensibility of the information in a prospectus. To that end, ESMA shall develop guidelines addressed to competent authorities on the supervision and enforcement with regard to prospectuses. In particular, ESMA shall foster convergence regarding the efficiency, methods and timing of the scrutiny by the competent authorities of the information given in a prospectus, using in particular the peer reviews pursuant to paragraph 13*."

Paragraph 13 builds on this article by stating that ESMA shall:

> "*conduct at least one peer review of the scrutiny and approval procedures of competent authorities, including notifications of approval between competent authorities. The peer review shall also assess the impact of different approaches with regard to scrutiny and approval by competent authorities on issuers' ability to raise capital in the Union*. […]."

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333 Consideration 8 Directive 2010/73/ on the prospectus to be published when securities are offered to the public or admitted to trading.

Whilst these articles essentially form a further elaboration of the consideration, it has given ESMA the option of using its powers and actively pursuing its wider mandate in regard to supervisory convergence in the field of prospectuses. The Regulation does not mention explicitly what powers ESMA can use, but it is probably to assume that these include the stronger powers such as instigating the breach of Union law if NCAs do not comply with the regulation or lower rules and standards.

Central Register

A second method under which ESMA sees a reinforcement of its role in the network is through the provisions of a central register. Once every prospectus has been approved by the relevant NCAs, these certifications of approval need to be communicated by the NCAs to ESMA, along with a copy of the prospectus.[334] ESMA is then obliged to include all these prospectuses in a central online storage mechanism, which functions as an online register.[335] This should allow investors to access and compare all Union certified prospectuses in one single location, and hence facilitate cross-border investments.[336]

Whilst this power is not explicitly, or directly related to supervisory convergence I would argue that it provides an incentive for further centralization of ESMA's position within the network of NCAs. The agency is well placed to assume this task, but also assumes an important extra competence. It is provided with extra information on the quality of all prospectuses, and can hence de facto compare the approved prospectuses from respective NCAs. Additionally, the maintenance of such an online registration makes ESMA into a central contact point, not just for NCAs but also for the private sector as investors will look to the agency's website for answers and opportunities.

The NCAs are obliged to supply additional information to ESMA concerning the approved prospectuses, that would allow ESMA to draft an annual report on the trend and developments in the EU prospectus field.[337] Ex. Art 47 of the Prospectus Regulation, ESMA must draft such an annual report analyzing the trends regarding issuers and issued documents. But additionally it needs to analyze and provide statistics concerning the notifications procedures of issued prospectuses. This includes the notifications of issuers to NCAs, but also of NCAs to ESMA. Hence, in the extended obligation of the central register, we find that ESMA has been given an

[334] Articles 21(5), 25 & 26 Prospectus Regulation.
[335] Article 21(6) Prospectus Regulation.
[336] Prospectus Regulation Proposal. P. 94.
[337] Article 21(5) Prospectus Regulation.

extra tool through which it can monitor, and exert influence on NCAs.

New provisions on co-operation between ESMA and the relevant authorities

Thirdly, the Prospectus Regulation appears to formalize in the field of prospectuses by introducing certain provisions that govern the relationships between ESMA and the competent authorities. Under Chapter VII of the regulation a framework is introduced that was previously absent in the Prospectus Directive. This framework sets out requirements around the designated authorities,[338] their required competences,[339] and how these authorities can and should cooperate.[340] It firstly requires each Member State to designate only one competent, administrative authority,[341] which concentrates the amount of actors in the network. In principle the authorities are bound to exchange information amongst themselves, but also fulfil requests for assistance or even engaging in on-site inspections.[342] Such requests need to be notified to ESMA.[343] If requests are then ignored, rejected or are not acted upon in reasonable time, ESMA can instigate proceedings against the NCA that refuses to cooperate on the basis of Article 19 of the ESMA Regulation, and instigate the breach of EU law via Article 258 TFEU.[344] Additionally, Chapter VII also provides for an arrangement between the NCAs and ESMA itself. The Prospectus Regulation reaffirms in a concise provision that the NCAs are bound to cooperate with ESMA and provide the agency with all information necessary, under reference to the ESMA Regulation.[345] It also enables ESMA to draft further implementing measures that provide a more precise outline of this envisioned cooperation.

Whilst the inclusion of these definitions in the prospectus is not uncommon, it is of significance. Certain other pieces of financial legislation already included such provisions prior to the prospectus regulation, making them not uncommon or extraordinary.[346] However, the inclusion of this system in the Prospectus Regulation, as goes for the other arguments mentioned above, reaffirms ESMA’s competence in this sphere of the law where it was not explicitly noted down before. Additionally, these specific provisions fit in well with the network model of supervisory convergence. It designates competent authorities, encourages these to cooperate in a network model, but also provides ESMA as a central controlling authority with the competence to enforce such cooperation. Hence, it affirms that ESMA’s holds this authority and NCAs are to a certain

338 Article 31 Prospectus Regulation.
339 Article 32 Prospectus Regulation.
340 Article 33 Prospectus Regulation.
341 Consideration 72 Prospectus Regulation.
342 Article 33(1), (3) & (4) Prospectus Regulation.
343 Article 33(4) Prospectus Regulation.
344 Article 33(5) Prospectus Regulation.
345 Article 34(1) & (2) Prospectus Regulation.
346 Compare for example Article 79 MiFID II or Article 24 MAR.

degree subordinated in the network as they can be bound to cooperate.

Regulatory powers

Lastly, a fourth way in which supervisory convergence is strongly promoted in the Prospectus Regulation, is through the additional capacity of ESMA to create draft legislation and adopt soft law measures. As pointed out under 5.2.1 the draft legislation can include issuing both ITS, as well as RTS. The guidance through soft law measures can entail adopting guidelines and recommendations. The initial prospectus regime already provided for a role of the CESR to issue such forms of lower regulation in the framework of the Lamfalussy regime.[347] The Prospectus Directive allowed the Commission to consult the ESC in the adoption of implementing standards.[348] In addition the revised Prospectus Directive of 2010 noted that ESMA could issue guidelines regarding the conditions of a proportionate disclosure regime.[349] The directives did encourage the Commission to adopt ITS and RTS concerning specific provisions,[350] but did not provide such a role for any other authority. This led to the Directive ultimately being supplemented by fifteen delegated legislative documents, including implementing acts, delegated forms of regulation and regulatory technical standards as drafted by the Commission.[351]

The new Prospectus Regulation however, appoints the majority of this competence to create legislation as a responsibility to ESMA. The regulation reiterates that "*[a]s a body with highly specialised expertise, it would be efficient and appropriate to entrust ESMA with the elaboration of draft regulatory technical standards which do not involve policy choices, for submission to the Commission*."[352] In particular it positions ESMA as the authority that is to develop the ITS and RTS, which is then to be adopted by the Commission in accordance with the procedure laid down in the ESMA Regulation, instead of attributing these tasks directly to the Commission as under the previous regime.[353]

Additionally, the regulation has confirmed ESMA's power to issue guidelines towards NCAs in

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347 J. P. Franx, 'Disclosure Practices under the EU Prospectus Directive and the Role of the CESR', *Capital Markets Law Journal* 2007*,* Vol. 2. No. 3, pp. 295-305.

348 Consideration 40 and Article 24 Prospectus Directive 2003/71/EC.

349 Consideration 18 Directive 2010/73/EU.

350 For example: Article 1(4) Directive 2003/71/EC on adopting implementing measures concerning definitions, Article 4(3) Directive 2003/71/EC on adopting implementing measures concerning technical exemptions, or Article 5(5) Directive 2003 71/EC on adopting implementing measures on the format of prospectuses.

351 See for a concise overview: Commission, *Implementing and delegated acts on Directive 2003/71/EC*, 2017. Available at: https://ec.europa.eu/info/sites/info/files/prospectus-directive-level-2-measures-full_en.pdf.

352 Consideration 80 Prospectus Regulation.

353 Article 25(8), Article 26(6), Article 33(7), Article 34 (3) Prospectus Regulation. Only Article 29 keeps the drafting responsibility directly with the Commission for the offer of securities on the regulated market under a third-country approved prospectus. De facto, however, ESMA is currently the authority dealing with authorisations.

the scope of the prospectus activities. As well as under the earlier cited Article 20(12) of the Prospectus Regulation, the agency is also entitled to issue guidelines on risk factors that ought to be identified in a prospectus and provide such guidelines or recommendations on what advertisement must undergo extra scrutiny in the offering of securities.[354]

It allows the agency to impose standards, where the regulatory framework did not explicitly allow it to do this before. This too contributes to ESMA's position and ability to effect supervisory convergence in the sphere of supervision on prospectuses. This is supported by the recent request of the Commission to ESMA on technical advice. In its request to ESMA, the Commission asks the agency for technical advice on delegated acts in light of the prospectus regime. This request covers many different spheres of the Prospectus Regulation, such as information to be included, formats and sequence, the criteria for scrutiny and the procedures for filing.[355] This effectively allows ESMA to exert a great deal of influence on the delegated regulations and steer NCAs on a convergent path in their practices of implementing the Prospectus Regulation.

7.1.3 Concluding Remarks regarding the Prospectus Regulation

The Prospectus Regulation does not effect a large change in the institutional order, but again incrementally contributes to ESMA's significance in this sphere of the law. The inclusion of supervisory convergence in the regulation, means that an important starting point is giver for ESMA to exert its mandate in the field of prospectuses. In this regard, it is relevant that ESMA can act as a referee in its oversight on the cooperation between NCAs, and enforce the obligation of cooperation that rests on the decentralized actors in the supervisory network. The centralization of all prospectuses, as well as its further regulatory powers, allow the agency to monitor developments on the prospectus market and influence further regulation in this field.

7.2 The Securities Regulation

Along with the Prospectus Regulation, another piece of legislation had been heralded as one of the two flagships of the CMU project: the Securities Regulation.[356] However, for this regulation the legislative process has not been as much of smooth sailing, as it has been for the Prospectus Regulation. A proposal for the Securities Regulation had been introduced by the Commission on the 30th of September 2015.[357] After a lengthy 'trilogue' between the Commisison, the Council

[354] Article 16(5), Article 22(10) Prospectus Regulation.
[355] Commission, *Request to ESMA for Technical Advice on Possible Delegated Acts,* 2017f. Available at: https://ec.europa.eu/info/sites/info/files/prospectus-directive-esma-mandate_en.pdf.
[356] Moloney 2016c. P. 378.
[357] Proposal for a Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation. Available at: http://eur-

and the European Parliament, a provisional version was negotiated that all parties agreed with, on the 30th of May 2017.[358] The final version has been amended significantly since the original proposal, but is still subject to a plenary vote by both the European Parliament and the Council before it will enter into force. However, the version as it stands now at the time of writing provides already provides further significant points as to how supervisory convergence can be established on the CMU.[359]

7.2.1 Introduction of the Securities Regulation

An important incentive to build the CMU, lay in observations from across the Atlantic. After the financial crisis of 2008, US securities markets rebounded swiftly, whilst EU markets lagged behind. The strong securities based financing in the US even absorbed a large part of the financial shock on credit institutions.[360] The instrument to build a strong EU securities market was chosen in the form of this Securities Regulation. In particular, it aimed to achieve such a market for increasing investment, but guaranteeing proper risk management at the same time.

The Commission therefore proposed a system that focused on more simple, transparent and standard ('STS') securities. This would allow securitisation to become more easily accessible, whilst at the same time reducing the inherent risks that are attached to such complex products. The implication of the STS label for a securitisation would be certain windfalls and categorization that would simplify the securitisation process. As the text currently stands, it is accompanied by an additional regulation that deals with certain revisions of CRR in regard to capital requirements and their relation to securitisation. However, this element falls outside the scope of this thesis, focusing instead on the relevant supervisory and institutional provisions.

7.2.2 Introductions regarding supervisory convergence

The Securities Regulation introduces four new provisions regarding supervisory convergence. Firstly, it attributes a direct supervisory role to ESMA in regard to securitisation repositories. Secondly, it expands ESMA's intervention powers to the field of securitisation. Thirdly, the regulation assigns ESMA the role to maintain a centralized list of all STS transaction. Fourthly, the regulation provides for new provisions on supervisory convergence regarding the cooperation between national authorities. Fifthly, the regulation provides for new fields in securitisation

lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015PC0472

[358] Council, *Capital markets union: agreement reached on securitisation* (Press Release), 314/17, 2017.

[359] Reference to the Securities Regulation, will mean for this thesis reference to the provisional agreed text Council, 2015/0226 (COD). Available at: http://data.consilium.europa.eu/doc/document/ST-10560-2017-ADD-1/en/pdf

[360] A. Kern, 'Capital Markets Union from the perspective of the banking industry and prudential supervision', *Law and Financial Markets Review* 2015, Vol. 9, No. 3, pp. 191-195. P. 191.

where ESMA can use its regulatory powers to introduce new standards for national authorities to coordinate their supervisory behaviour.

Direct Supervision over securitisation repositories

The first and foremost important introduction of the Securities Regulation, regards the direct supervision of securitisation repositories. After the trilogue between the legislative powers of the Union, new requirements were introduced regarding the transparency of securitisations in order to quality for the STS label. These requirements govern the underlying exposures, structuring, investing reports, risks, the originator, sponsor or special securitisation purpose entity E') of the securitisation.[361] All this information needs to be stored at newly created entities, referred to as 'securitisation repositories'. The obligation to provide this information rests on the originator, the sponsor and the relevant SSPE of the securitisation.[362] The securitisation repositories are defined in the regulation as '*a legal person that centrally collects and maintains the records of securitisations.*'[363] Security repositories serve to centralize and provide access to all relevant information, particularly on exposures.[364] In this regard, they fulfil a similar role as the trade repositories under EMIR, and are subject to a similar regime, including direct supervision by ESMA.

The securitisation repository has to register with ESMA for authorisation, where it has to meet the same requirements as a trade repository under EMIR such as governance, and operational requirements.[365] This shall allow it to perform its tasks across the entire Union, but ESMA does need to consult the relevant competent authorities, where the securitisation repository will be established.[366] Once the registration has been examined, and approved, ESMA has the same supervisory powers that the agency has under EMIR over trade repositories.[367] These include the powers to conduct request information, engage in general - and on-site inspections, impose fines, issue public notices or even ultimately withdraw the registration. The fees for registration and supervision will be levied by ESMA on the securitisation repository.[368]

These powers signify not a complete new introduction, due to the fact that they're very similar to the powers ESMA already had under EMIR regarding trade repositories. However, a few important observations must be made regarding the significance of this new regime for

[361] Article 7 Securities Regulation.
[362] Article 13, Consideration 13 Securities Regulation.
[363] Article 2(23) Securities Regulation.
[364] Consideration 12 Securities Regulation.
[365] Article 8 Securities Regulation, in conjunction with Articles 78-80 EMIR.
[366] Article 9 Securities Regulation.
[367] Articles 12 & 13 Securities Regulation, in conjunction with Articles 61-68, 73 and 74 EMIR.
[368] Article 14 Securities Regulation.

supervisory convergence. Firstly, it is clear that the CMU can provide a strong incentive to legislate new areas such as securitisation and through this process bring new competences towards ESMA. The direct supervision will allow ESMA to achieve the same standards of supervision over these new securitisation repositories by performing all this supervision itself. Secondly, the increasing scope of ESMA's direct supervisory role on these securitisation repositories signifies an expansion of ESMA's powers and a stronger reinforcement of ESMA's direct powers. It is in this regard also a testimony to the previous effectiveness of ESMA in its role in the supervision of the trade repositories. Thirdly, it should be noted that these introductions occurred in the process of the trilogue, and not in the original proposal. This demonstrates that it is not only the Commission that possesses confidence in ESMA's ability to engage in direct supervision of these entities, but also with the Council and the European Parliament as the two other legislators.

Intervention Powers

A strong new supervisory power that the Securities Regulation introduces regarding securitisation is ESMA's power to intervene in the market. Following an inconspicuous, small provision in Article 29(7) of the Securities Regulation, ESMA is enabled to intervene in the securitisation market. The provision states that ESMA shall monitor the EU securitisation market, and make use of its temporary intervention powers in line with Article 40 MiFIR. This article was already broadly phrased and allowed ESMA to ban: "the marketing, distribution or sale of certain financial instruments or financial instruments with certain specified features; or a type of financial activity or practice."

Arguably, securitisation could have fallen under these definitions. Seeing as the specified features element has not been defined under MiFIR, it is now certain that ESMA can directly intervene in the securitisation market with the introduction of the Securities Regulation. In regard to supervisory convergence, it allows ESMA to assume a more centralized role and act upon its monitoring role. The regulation broadens ESMA's powers to also in direct relation to the market. The importance of this lays essentially in the fact that ESMA's position *vis-à-vis* the market is once more reinforced for the agency to act directly towards the market and its actors, rather than through national authorities. Therefore, it provides ESMA with a stronger centralized position.

Central list of STS transactions

Similar to the Prospectus Regulation, Article 27 of the Securities Regulation introduces a new role for ESMA to maintain and publish a list of all securitisations that qualify for the 'STS label'. Both originators and sponsors of STS securitisations need to notify ESMA when a securitisation meets the STS label, accompanied by an explanation of how the STS criteria are met in the specific securitisation.[369] Following such a notification, ESMA will publish a list of all securitisations that meet these criteria. Additionally, the sponsor and the originator need to inform the relevant NCAs of the notification made.[370] The compliance with the STS criteria however, remains the responsibility of the originator, the sponsor and SSPE. Publication of the list by ESMA, does not mean therefore that ESMA has certified the securitisation as compliant with the STS criteria. Instead, the responsibility – and therefore the liability – lies with the originator, sponsor and SSPE.[371] This gives the supervision of the STS-criteria an ex-post character, seeing as failure to comply can be effectively enforced afterward towards the originator, sponsor and SSPE, but does not create an obligation for ESMA or the NCAs to check compliance prior to admission to ESMA central list of STS criteria. It is then afterward for the relevant NCAs to ensure compliance of STS securitisations with the relevant criteria.[372] Should a securitisation turn out to be in non-compliance with the criteria, and the NCA can and should impose administrative sanctions, after which ESMA shall publish the administrative sanctions on its list for the relevant securitisation.[373]

The significance of this framework for supervisory convergence lies in the fact that firstly ESMA forms a central hub for disseminating information. It is the agency that maintains the list for investors to see what securitisations meet the STS criteria. Hence, ESMA is the organization that allows market actors to make use of the benefits of the Securities Regulation. Whilst the enforcement remains with NCAs of the STS criteria, the publication of administrative sanctions in a centralized list by ESMA provides for an EU wide 'naming and shaming' regime for the parties involved in that specific securitisation. It does not strongly draw supervision to a higher, centralized EU level, but does introduce a system with a stronger pan-EU method of both recognition, and afterwards pressure on enforcement, as the next paragraph will also demonstrate.

New provisions on co-operation between ESMA and the relevant authorities

The third relevant introduction for the regime of supervisory convergence is the framework regarding the provisions on cooperation between the relevant NCAs. What can be observed is that the Securities Regulation also reinforces ESMA's position in the network model, and endows the agency with further supervisory convergence powers regarding the NCAs and other ESAs.

Article 29 of the Securities Regulation requires Member States to assign, and set out a

[369] Consideration 31 Securities Regulation.
[370] Article 27(3) Securities Regulation.
[371] Consideration 31 Securities Regulation.
[372] Article 29 Securities Regulation.
[373] Article 27(5) in conjunction with Article 32 Securities Regulation.

supervisory regime with designated competent authorities for their respective securitisation regimes. Whilst this sounds only reasonable, it creates an important obligation. Due to the fact that securitisation can involve a variety of markets actors such as both credit institutions as defined under CRD IV (both significant and non-significant), investment firms as defined under MiFID, UCITS, or AIFMs. These competent authorities then need to be endowed by the Member States with the appropriate and necessary supervisory, investigatory and sanctioning powers.[374] The Regulation provides a specific regime for NCAs on when the breach of an obligation of this regulation leads to at least the imposition of an administrative sanction.[375] A novelty in this regard is that ESMA fulfils a monitoring role regarding the administrative sanctions imposed by NCAs. First of all, an obligation to publish the administrative sanctions rests on the NCAs, including the nature of the infringement, the responsible people and the sanction imposed.[376] ESMA must then be informed of any such imposed sanctions and afterwards maintains a central list of the sanctions imposed, which will be accessible to all NCAs.[377] In the original proposal the maintenance of such a list task fell jointly to all NCAs, however this was revised after the trilogue to be maintained solely by ESMA. This essentially allows NCAs to consult the enforcement of the securitisation regime by their colleague institutions.

Article 36 provides a more specific regime on the cooperation between all the designated NCAs. Under this article a framework for supervisory convergence is established. All relevant NCAs are bound to cooperate and coordinate with the ESAs and each other, in the supervision of the securitisation market. In particular the second paragraph of Article 36 encourages the NCAs to focus on coordination through soft law and policy measures, as they should: "*develop and promote best practices, facilitate collaboration, foster consistency of interpretation and provide cross-jurisdictional assessments in case of any disagreements.*"[378] However, the third paragraph has a stronger institutional set-up where: "[a] *specific securitisation committee shall be established within the framework of the joint-committee of the ESA*s, *within which [NCAs] cooperate to carry out their duties pursuant to this Regulation."*[379] No further guidance is available in policy documents as to how such a joint-committee would function precisely, but one may expect that it would provide an extra platform for both NCAs and different ESAs to discuss development, evaluate practices and exchange information on their respective mandates and obligations. In addition to this joint-committee, the Securities Regulation makes assigns ESMA an extra role to evaluate the framework of co-operation between NCAs. The regulation stresses

[374] Article 30 Securities Regulation.
[375] Article 32 Securities Regulation.
[376] Article 37(1) & (2) Securities Regulation.
[377] Article 37(6) & (7) Securities Regulation.
[378] Article 36(2) Securities Regulation.
[379] Article 36(3) Securities Regulation.

that ESMA in particular should engage in peer-reviews in order to assess the effectiveness of this co-operational framework.[380]

The framework of supervisory convergence set out in the Securities Regulation therefore does not contain general obligations to exchange information, as laid down in EU financial legislation such as MiFID,[381] broadly defined duties such as in the current version of EMIR,[382] but contains a framework which actively provides for different methods of achieving supervisory convergence.

Regulatory Powers

Lastly, as was the case for the Prospectus Regulation, also the Securities Regulation provides for certain fields where ESMA is to make use of its regulatory powers. In the case of the Securities Regulation there are a variety of fields which will need to be regulated by ESMA. These include different standards in the form of both ITS and RTS. Whilst ESMA's expertise is recognized in the process of drafting such rules, and seen as the main reason for the agency to engage in this process, ESMA must consult the EBA and EIOPA during the process.[383] This is an important acknowledgment of the overlaps that securitisations play between capital markets and the banking market. The attention therefore to involve all three ESAs in the rulemaking process is an important step to creating uniform rules for all market players in this field, using expertise from different areas. As pointed out under 3.2, the new governance structures of the ESAs allow them to channel such information and in this scenario take their respective markets into account in the rulemaking process.[384]

As pointed out before, the new regulatory capacity of ESMA allows it to fill in the further lower regulatory obligations of the Securities Regulation. This means that it can exert influence on the implementation, application and interpretation of the Securitisation Regime, and steer the NCAs in the performance of their tasks. In this regard, the Securitisation regime offers a great number of provisions where ESMA is assigned a regulatory role.[385] The most important provision in regard to supervisory convergence is that following however consideration 45 in conjunction

[380] Article 36(7) Securities Regulation.
[381] Chapter II MiFID II.
[382] Article 23 Securities Regulation.
[383] Considerations 42-45 Securities Regulation.
[384] The EBA can draft regulatory standards in the field of risk requirements after consulting ESMA (Article 6(7) Securities Regulation).
[385] This includes: regulatory power to create draft legislation on information obligations for sponsors, SSPEs and originators (Article 7(3) Securities Regulation), application procedures for securitisation repositories (Article 8 Securities Regulation), data to be held in securitisation repositories (Article 15(2) Securities Regulation), when resecuritisation exemptions Article 16(5) Securities Regulation), information requirements for the notification of STS securitisations (Article 27(6) & 27(7) Securities Regulation), information requirements for applications for third parties involved (Article 28(4) Securities Regulation).

with Article 36(8) ESMA is to draft regulatory standards regarding the cooperation and information obligations between NCAs. The provision does not give any specificity on how ESMA should compose these draft RTS, or to what extent the agency is free to impose new targets or actions on the NCAs. This gives ESMA a very broad mandate to shape the relationships between the NCAs in terms of coordination and informational exchanges in its regulatory capacity. Therefore, this provides a significant opportunity to further shape the framework of supervisory convergence through lower regulation. At the time of writing, no indication at one of the trilogue partners, or ESMA itself has been given as to how the agency plans to make use of this capacity.

7.2.3 Concluding Remarks regarding the Securities Regulation

The current version of the Securities Regulation introduces a number of different relevant provisions for supervisory convergence. One can notice an increase of both the direct supervision, through the introduction of ESMA's central supervision on securitisation repositories, and the attention for more decentralized methods of supervisory convergence, where NCAs are bound to coordinate their supervision or develop best practices. Supervisory convergence therefore forms an important part of the regulation as it currently stands, although it remains subject to a final vote of the Parliament and Council. For ESMA, we see a strong increase in its mandate in direct supervision, and an increase in its supervisory and regulatory powers. As one of the most important policy priorities of the CMU, this regulation forms a good example of how the CMU project can drive forward supervisory convergence using different methods.

7.3 Central Counterparties and EMIR

Another important change in regard to the supervisory convergence framework can be found in the newly proposed changes to EMIR. EMIR governs not only trade repositories as pointed out under 5.2.3, but also CCPs fall within the scope of this regulation. It is in regard to the latter that a significant shift in the supervisory framework would occur should two proposals to revise EMIR be adopted.

7.3.1 CCPs under EMIR

EMIR was introduced in 2012 with the aim to regulate the OTC derivative market. It required all derivatives that were sold OTC to be cleared through a CCP. In doing so, the CCP positions itself between the parties and 'clears' the transaction by buying the product from the seller, and selling the product to the buyer.[386] This ensures that the platform mitigates credit risk and liquidity risk, by netting existing exposures multilaterally.[387] It also creates transparency as the OTC derivatives are now traded through such a platform, but at the same time this creates an increased reliance on CCPs in the financial system. More specifically, CCP activity has doubled since 2009.[388] This growing importance of the CCPs and their interconnected role with other financial institutions should be accompanied by an adequate framework for supervision and resolution.[389]

Currently the supervisory framework functions already through a network model that is designed to take supervisory convergence into account. Each CCP is supervised in its day-to-day supervision by a competent authority in the Member State where it is established.[390] For certain special processes however, EMIR makes use of a system of supervisory colleges. Such a supervisory college is established and chaired by the competent authority and includes ESMA, as well as the relevant competent authorities that supervise the CCP's clearing members, its trading venues, the central securities depositories to which it is linked, and the CCPs with which interoperability agreements are concluded.[391] Also the central banks of the most relevant Union currencies in which the CCP clears its financial instruments are represented in the supervisory college.[392] These supervisory colleges can hence constitute a large number of players. They are responsible for specific supervisory tasks. The college is in particular responsible for the authorisation of the CCP.[393] It may grant authorisation to extent the activities of the CCP as they were laid down in the original licence.[394] The supervisory college may provide an opinion on the models of clearing the CCP uses, and the stress tests it conducts (including an opinion on the collateral or margin requirements, or default fund contributions).[395] Lastly, the supervisory college is responsible for approving any interoperability agreement between different CCPs.[396]

7.3.2 Revisions regarding supervisory convergence

Two recent proposals of the Commission to amend EMIR shed light on how supervisory convergence can further be accomplished and provide an insight as to how ESMA's future role

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[386] D. Domanski, L. Gambacorta & C. Picillo , 'Central clearing: trends and current issues', *BIS Quarterly Review* 2015. Available at: http://www.bis.org/publ/qtrpdf/r_qt1512g.pdf. P. 60.
[387] J. Kiff e.a., 'Meeting new challenges to stability and building a safer system', *IMF Global Financial Stability Report* 2010, No. 1. P. 92.
[388] Commission, *Central Counterparties Recovery and Resolution Proposal: Frequently Asked Questions* (Fact Sheet), MEMO/16/3990, 2016d.
[389] Commission 2016d.
[390] Article 22 EMIR.
[391] Article 18(2) EMIR.
[392] Article 18(2), sub h EMIR.
[393] Article 17 EMIR.
[394] Article 15 EMIR.
[395] Article 49 EMIR.
[396] Article 51 & 54 EMIR.

under this regulation might change. These proposals shall be discussed in a reversed chronological order. Firstly, the most relevant proposal to amend EMIR is the Proposal concerning the supervisory frameworks of CCPs of the 13th of June 2017 ('the June Amendment'). The second relevant proposal concerns the general review of the 4th of May 2017 ('the May Amendment').

The June Amendment

The most relevant proposal to the question how the CMU initiative affects supervisory convergence, is the most recent proposal, which was based on the CMU Mid-Term Review.[397] On the 13th of June the Commission published a new proposal that, in the interests of the CMU project would intend to create a more effective and consistent system of supervision.[398] According to the Explanatory Memorandum of this proposal cross-border supervision of clearing systems would not only be necessary to facilitate further integration, but also once an integrated market has been established it would be vital to supervise this market adequately.[399] In addition to this CMU related incentive, the Commission makes three important observations that require a revision of the supervisory framework of CCPs. Firstly, as noted above, there is one competent authority in charge with the day-to-day supervision of a CCP. However, recently the growing international importance of CCPs is putting constraints on this single home-state based model of supervision, despite the use of supervisory colleges for certain aspects of authorisation. Secondly, related to the CMU objectives, the Commission notes that still supervisory differences remain in place concerning CCPS across the Union. Lastly, the Commission observes that central banks are not sufficiently involved in the supervision of CCPS.[400]

The Commission proposal introduces a few important new measures in regard to the supervision of the CCPs, both in EMIR and the ESMA Regulation. The first important change relates to the EU-established CCPs. The proposal suggests the creation of a new supervisory mechanism, under ESMA in the form of the 'Board of Supervisors in CCP Executive Session' ('CCP Executive Session'). This CCP Executive Session would be comprised out of permanent, and non-permanent members. The permanent members would consist out of a Head and two Directors with voting rights, a representative from the Commission, and a representative from the ECB. The last two would not have voting rights. The non-permanent members with voting rights would be representatives from the NCAs for each CCP established in the Union in relation to which the

[397] Commission, *Commission proposes more robust supervision of central counterparties* (Press Release), IP/17/1568, 2017g.
[398] Proposal for a Regulation amending EMIR as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs ('June Amendment').
[399] June Amendment.
[400] Consideration 7 June Amendment.

CCP Executive Session is conferred.[401] Additionally non-permanent members without voting rights would be representatives from the relevant central banks for each CCP in relation to which the CCP Executive Session is conferred. The Head and two directors of the CCP Executive Session would assume a role as non-voting members in the Board of Supervisors of ESMA.[402] The Head of the CCP Executive Session prepares and Chairs the meetings.[403] In its functioning, the Executive Session is supported by administrative staff of ESMA and adequate resources to the extent that this is required to guarantee its effectiveness and independence.[404]

This Executive Session is provided with the final say on the most important supervisory decisions pertaining to the relevant CCP. According the new draft Article 21a of EMIR, the national competent authority remains responsible for drafting initial decisions regarding the CCP for example on the field of: "*access to a CCP, access to a trading venue, authorisation of the CCP, extension of activities and services of a CCP, capital requirements, withdrawal of authorisation, review and evaluation, shareholders and members with qualifying holdings, information to competent authorities, review of models, stress testing and approval interoperability arrangements*."[405] However, these draft decisions will be the subject to ESMA's approval in the CCP Executive Session. Hence, the CCP Executive Session is an extension of the form of the supervisory college. However, as the enumeration above points out, new topics are added to the competence of the Executive session instead of only the authorization, the extension of the licence, the stress testing and the approval of the interoperability agreements. However, should ESMA not agree with a decision, then it is considered not to be taken, or ESMA can amend a decision, which will only become valid if and once ESMA's suggestions have been followed. Should an NCA not agree with the final decision of ESMA, the decision will be sent on to the Board of Supervisors. However, ESMA is also enabled through the new article 21a of EMIR to take final decisions towards an individual market participant. Article 21b EMIR governs the relationship between CCPs and central banks. More relevant, in this respect is that Article 21c obliges the CCPs to pay all supervisory fees related to these costs. This enables ESMA instrumentally to further pursue its goals.

These are considerable expansions of ESMA's powers regarding the EU established CCPs, as it no longer participates in a supervisory college, but such a college is brought under the own umbrella of ESMA in the form of the Executive Session. Whilst a different regime applies to the trade repositories and credit rating agencies, the Executive Session brings the CCPs in ESMA's

[401] Article 1(7) June Amendment.
[402] Article 1(4) June Amendment.
[403] Article 1(9) June Amendment.
[404] Consideration 17 June Amendment.
[405] Explanatory Memorandum to the June Amendment. P. 22.

scope of supervision. Though preparatory work remains with NCAs, the Executive Session (and therefore ESMA) carries the final responsibility. An important difference regarding the functioning of Executive Sessions and the supervisory colleges, is that the meetings are now prepared and chaired by the Head of the Executive Session, instead of the competent authority of the home state of the CCP. This ensures more consistency between the different meetings of the CCPs and allows for the supervision of EU CCPs to be conducted along more similar lines. Whilst the involvement of the relevant NCAs does not immediately create a centralized model of supervisory convergence for CCPs, it cannot be denied that this represents a further centralization of ESMA's supervisory competences. Relevant in that regard is that it additionally creates the opportunity to independently raise finances from the supervised parties and for ESMA to pursue supervisory convergence hence in a more independent manner.

When it comes to third-country CCPs, the proposal makes an important distinction between CCPS that are non-systemically relevant by referring to these as Tier 1 CCPs, whereas systemically relevant CCPs are referred to Tier 2 CCPs. The first important change in that respect is that it would be ESMA that would be in charge of assigning such a classification to the relevant CCP.[406] In doing so ESMA will assess four criteria, as laid down in Article 25(2a): 1. The nature, size and complexity of the third-country CCP; 2. The effect that the failure or a disruption to the third-country CCP would have on critical markets, financial institutions or the broader financial system and on the financial stability of the EU; 3. The clearing membership structure of the third-country CCP; and 4. The relationship, interdependencies or other interaction with other financial market infrastructures of the third-country CCP.

The second, perhaps most drastic change of all, is that ESMA would become responsible for the direct supervision of a third-country CCP when it is categorized as Tier 2. In principle the regime provides for a 'proportionate form of supervision of the third-country CCP'. This entails that ESMA assesses the system of equivalence between EMIR and the third-country regime. It can then declare that the NCA of the third-country adequately fulfils the supervision of a specific EMIR provision, after which it can waive the application of this EMIR provision. The proposal also stipulates that ESMA should have the power to recommend to the Commission that a Tier 2 CCP should not be recognized if that CCP is of such systemic relevance that its systemic importance cannot adequately be covered by a regime of recognition.[407] According to the proposal, such a CCP should file for authorization with a Member State in that case, after which the CCP Executive Session can take a decision on the draft authorization decision prepared by

[406] Considerations 33-35, Article 25(2a) June Amendment.
[407] Explanatory Memorandum to the June Amendment. Pp. 25-26.

that Member State. It is not entirely unlikely these proposed changes are motivated by the impending Brexit from the EU. After all, this is an effective legal and policy to attract investments from the UK and offer them an incentive to settle in a EU Member State.

Of more immediate relevance to the research question, however, is a brand new supervisory power for ESMA regarding these third-country Tier 2 CCPs. Article 44b grants the CCP Executive Session the task of supervising the recognized third-country CCPs. The new articles 25a-25n of EMIR provide a new set of rules under which the Executive Session can supervise these third-country CCPs in order to ensure that they comply with the requirements of recognition. These rules include the powers to request information, conduct on-site inspections, hear persons, and impose fines or periodic penalties. These supervisory powers are hence similar to those powers ESMA already holds in regard to the trade repositories and CRAs.

In this way the new proposal, as accelerated by the CMU agenda, brings the most significant third-country CCPs under centralized supervision of ESMA. It will hence make sure that ESMA is a better-suited position to effect supervisory convergence, not only towards EU established CCPs, but also to third-country CCPs that are active in the EU. This position follows a centralized model regarding Tier 2 third-country CCPs. However, it remains to be seen if the proposal is adopted unamended, and how many Tier 2 CCPs would ultimately be subject to such a regime.

The June Amendment has introduced the CCP Executive Session as an interesting, new concept of a supervisory mechanism. It signifies an important centralizing factor through switching to a a more institutionalized structure with under a set up with a permanent management, administrative staff and resources under ESMA. Amongst constructions like supervisory colleges, joint supervisory teams, peer reviews, this introduction by the June Amendment is to be seen as an innovative addition to an already complex landscape of EU supervisory institutions and mechanisms.

The May Amendment

The May Amendment was also brought forward as a policy instrument to adjust EMIR in order to strengthen and deepen the CMU.[408] The May Amendment can be considered as a substantial alteration to the existing framework. Few important substantive obligations are newly inserted or

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[408] Proposal for a Regulation amending EMIR as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories (‘May Amendment’). P .6. Commission, *Commission proposes simpler and more efficient derivatives rules* (Press Release), IP/17/1150, 2017h.

amended for CCPs, for example concerning reporting obligations, clearing obligations for pension funds, small financial counterparties, or non-financial counterparties. I will focus on the most pertinent changes to supervisory convergence. As with the June Amendment, these changes pertain again to an incremental increase in ESMA's powers, be it less drastic than the aforementioned amendment.

Firstly, the revision of the regulation changes certain provisions regarding the framework of supervision of the trade repositories. Article 1(13) of the June Amendment proposes to increase the fines that ESMA can impose on trade repositories, ex. Article 65 EMIR, from €20.000 up to €200.000 Euros. This ten-fold increase can easily be considered as substantial. Additionally new possible infringements are added to the list for requirements of trade repositories, for example if the trade repository fails to notify ESMA of a change to its registration conditions.[409] ESMA had previously already asked for such an increase in its ability to impose fines,[410] and the fulfilment of this request supports ESMA's ability further to impose effective direct supervision on the entities it directly supervises. After all for supervision to be effective, it means that the responsible authority can require Union law to implement EU law in a manner that is effective, dissuasive, and proportionate.[411] Especially dissuasiveness is now arguably more attainable for ESMA in its supervisory role, which would allow ESMA more easily to steer for supervisory convergence.

Secondly, the May Amendment provides ESMA with a new power. The proposal contains a new Article 6b, where ESMA may request the Commission to temporarily suspend any clearing obligation for a specific class of OTC derivatives or for a specific CCP. For the Commission to fulfil such a request, ESMA has to provide evidence that certain specific conditions are fulfilled.[412] Such a suspension of the clearing obligation could be necessary, according to the Explanatory Memorandum of the May amendment because sometimes: "*application of the clearing obligation may be impossible [e.g.] because the CCP clearing the biggest portion of a certain OTC derivatives class may exit that market or may have adverse effects for financial stability [for example when] the clearing obligation would impede bilateral hedging for counterparties without access to the centrally cleared market*." This new ability that is included in the scope of ESMA's powers, means that ESMA can not only suspend certain market activities

[409] Art 1(16) of the May Amendment introduces the new Article 78(9)
[410] ESMA, 2017d. P. 4.
[411] Case 68/88 Commission v. Greece (Greek Maize) [1989] , ECLI:EU:C:1989:339 Para. 24. J. H. Jans e.a., *The Europeanization of Public Law,* Groningen: Europa Law Publishing 2007. P. 207.
[412] As outlined in Article 6b(1) of the May Amendment, this can be the case if 1. The class of the derivative is no longer suitable for clearing; 2. A CCP is likely to stop clearing that type of class of derivative; 3. The suspension of that class of OTC derivatives is necessary for the financial stability of the Union.

on a legal basis, such as is the case under MiFIR or the Shortselling Regime, but may also request the Commission to temporarily lift existing legal obligations. I would argue that this goes further than the previous powers: lifting a legal standard that prescribes a precise obligation for a specific market participant, goes further than imposing a ban on an activity. Although the nature of the suspension of the clearing obligation would be temporary, it constitutes the ability for ESMA to approach the legal framework in a more flexible manner, and have specific regards for the individual circumstances of a CCP. It must therefore be considered as a new, extra tool in ESMA's supervisory toolbox. In terms of supervisory convergence, it amplifies ESMA's reach, and allows it to consider new methods of achieving its intended aims of supervision for all CCPs. After all, it is about the same application of the same rules, in order to achieve the same outcome whilst using similar measures. This is a new measure for ESMA to achieve its intended goals.

Lastly, the May Amendment provides five new areas where ESMA is required to help in the standard setting that were to contribute to a more harmonious implementation of EMIR. More specifically, this is expected of ESMA in the field of risk management requirements for CCPs,[413] reporting requirements for CCPs,[414] data validation by trade repositories,[415] simplified application procedures for trade repositories,[416] and data availability in trade repositories.[417] Whilst these powers again, arguably see to the regulatory side of ESMA's mandate, it should be recalled that the borderline between supervision and regulation can be permeable. Through increasing the specificity of lower rules addressed to NCAs, this can provide guidance on the implementation of higher EU regulations and contribute to supervisory convergence.

7.3.3 Concluding Remarks regarding EMIR

The revision of EMIR is still subject to amendments and ultimately voting by both legislators. Therefore one cannot be certain of what provisions relevant to supervisory convergence will make it into the final version. However, in the example of both the Prospectus Regulation and the Securities Regulation, both legislators have strengthened the supervisory convergence provisions. Even though the direct supervision of CCPs under the June Amendment may be more politically sensitive, the advantages are particularly strong due to the impending Brexit. It would force four CCPs to establish themselves in the Union.[418]

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[413] Article 1(9) May Amendment.
[414] Article1(7), point c May Amendment.
[415] Article 1(16) May Amendment
[416] Article 1(12), points b & c. May Amendment.
[417] Article 1 (17), point c May Amendment.
[418] LCH Ltd., CME Clearing Europe Ltd., LME Ltd., ICE ClearEurope Limited. See also: ESMA*, List of Central Couterparties authorised to offer services and activities in the European Union*, ESMA70-148-523, 2017e.

The proposals put forward by the Commission contain far-reaching changes to the current supervisory regime in EMIR. The June Amendment centralizes supervision, through the Executive Session under ESMA's flag. The system still relies on strong cooperation between NCAs, but ESMA has become unmistakeably the platform to accomplish this. It can also ensure consistency in the line of supervision through its further institutionalization in the form of permanent management of the Executive Session, administrative staff, and additional resources. The raising of fines, and increase in ESMA's intervention powers as introduced by the May Amendment allows ESMA to implement a stronger regime regarding its supervised entities. Therefore, EMIR effects a further centralization of the supervision mandate, but also a reinforcement of ESMA's position as a central entity within the network.

This is the end, according to Aristotle,
what we have all been waiting for,
what everything comes down to,
the destination we cannot help imagining.
- B. Collins, *Aristotle*

8. Conclusion

The CMU project is an ambitious project of the Commission to drive integration of capital markets forward across the Union. This integration of capital markets offers several important advantages, such as risk spreading, freeing investment and facilitating competition. Such integration must be accompanied however by adequate standards of supervision across all EU Member States. Fostering supervisory convergence is hence an important pillar in this process, which in turn will help to achieve the other objectives of the CMU. The Commission has not chosen a definite way of pursuing this goal. Two models can be characterized in this process: a central model or a network model. Under the current framework it seems that ESMA, which is tasked with fostering supervisory convergence, forms a hybrid model of the two. In order to pursue this objective of supervisory convergence ESMA has asked for increased resources and an expansion of its powers.

When assessing the CMU related legislation, we can observe an incremental, but clear development. The three pieces of assessed regulation contain measures through which supervisory convergence is or could be advanced. In some cases, this is through smaller incremental changes that bring for example the prospectus field into ESMA's scope of powers, and where the legislator creates new methods or clarifies existing methods as to how ESMA can coordinate the relevant NCAs in its network. In other cases, new provisions are introduced where ESMA will assume the role of a direct, central supervisor, as is the case for the securitisation repositories. In other cases a stronger institutionalization brings ESMA into a leading position towards the NCAs. An example of this is the CCP Executive Session, which still relies on cooperation of the NCAs on this platform but under guidance of management and staff that belong to ESMA. In all scenarios however, a certain degree of centralization can be observed: whether it is the introduction of intervention powers by ESMA, direct supervision or regulatory powers in new fields. Following this, supervisory convergence on the capital markets is being achieved with an incremental increase in ESMA's powers and mandate. It is therefore not a method of achieving supervisory convergence as the Banking Union has aspired to achieve by centralizing supervision of the most significant institutions in one authority. Instead, we see an incremental push in the individual pieces of legislation that move the supervisory competences and powers towards the Paris based agency.

The CMU project still makes use of measures that are typical of new governance in the EU. Emphasis is still put on measures of cooperation such as peer reviews, or best practices in both ESMA's supervisory convergence work programmes, and in legislation. However, the incremental centralization of ESMA places it often in a more hierarchical position towards the NCAs in its network of governance, and provides an opportunity for its soft law measures to harden. The incremental shift fits in well with the limited constitutional space left to the European legislator to increase ESMA's powers towards a central supervisor. Due to the Meroni doctrine, and its status as agency, a designation of ESMA as a full pan-EU supervisor for all capital markets actors and products in the CMU, would not stand a test by the ECJ under the current constitutional framework. However, at the time of writing the creation of a legislative proposal that reforms the ESAs is still ongoing. It can be considered very likely that such a reform will entail a substantial revision of the original ESA regulations, and further stretch the mandate of the ESAs to a more centralized position. However, a revision of the EU Treaties would be required in order to assign ESMA the full-on task of a pan-EU wide supervisor. Until then, ESMA's institutional position in the wider framework deserves to be closely followed. As the CMU has passed its Mid-Term Review and many CMU related legislation is yet to be unrolled, it would not be surprising if many more incremental changes are to follow. This requires close scrutiny as ESMA's legal competences and institutional position seem to grow quickly in these dynamic times of policymaking. Indeed a fully integrated Capital Markets Union, would be the perfect soil for ESMA to grow incrementally and solidify its central position in its network.

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