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Financial Regulation in the EU – cross-border capital flows, systemic risk and the European Banking Union as reference points for EU financial market integration

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Non-Technical Summary

In the aftermath of the financial crisis EU financial regulation has increasingly come into focus of the debate and quite a few fundamental reforms in the financial sector have been initiated since then. This raises the question of how they can be traced back to the financial regulation in the EU in the past. Therefore, the latter has to be discussed, its rationales and resulting problems have to be elaborated to understand why and how the reform as it stands today could evolve. As a result, the key driver of financial market integration, i.e. the accommodation of cross-border capital flows, emerges as the point of departure of the early regulatory strategies, such as the Banking Directives and the following Financial Services Action Plan of the European Commission. The Financial Services Action Plan entails various regulatory measures, which are partly looked at, such as the Markets in Financial Instruments Directive and the Market Abuse Directive highlighting the implications of the Action Plan. In order to come full circle with today's reforms, one also has to look at the orchestration of the underlying supervisory structures in the EU Member States.

Throughout the financial crisis it has become clear that further orchestration is needed. That is why the European Supervisory Authorities, which are responsible for microprudential supervision, have been set up. To better understand the overarching significance of the European Banking Union for macroprudential supervision and its underlying drivers, their background und framework is outlined. It becomes clear that the transition from the initial regulatory framework dominated by the concept of an accommodation of cross-border capital flows to that of the prevention of systemic risk is far from completed. Remaining questions raised by the interaction of the different regulatory mechanisms have yet to be resolved.

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Financial Regulation in the EU

– cross-border capital flows, systemic risk and the European Banking Union as reference points for EU financial market integration

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Abstract: This chapter provides an overview of EU financial regulation from the first banking directive up until its most recent developments in the aftermath of the financial crisis, focusing on the multiple layers of multi-level governance and their characteristic conceptual difficulties. Therefore the paper discusses the need to accommodate cross-border capital flows following from the EU internal market and the resulting regulatory strategies. This includes a brief overview of the principle of home country control and the ensuing Financial Services Action Plan. Dealing with the accommodation of cross-border capital flows and their regulation necessarily require an orchestration of the underlying supervisory structures, which is therefore also discussed. In the aftermath of the financial crisis of 2007-09 an additional aspect of necessary orchestration has emerged, that is the need to control systemic risk. Specific attention is paid to microprudential supervision by the newly established European Supervisory Authorities and macroprudential supervision in the European Banking Union, the latter's underlying drivers and the accompanying Single Supervisory Mechanism, including the SSM's institutional framework as well as the consideration of its rationales and the Single Resolution Mechanism closely linked to it.

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JEL Classification: G21, G28, G38, K22, K23

1. Conceptual Framework

Given its need for multidimensional coordination of financial regulation, the EU example illustrates very well the multiple layers of multi-level governance and their characteristic conceptual difficulties and problems, which regional coordination demands. In order to bring these into focus against the EU background, the over-arching Treaty goal to construct an internal market according to Art 2 and 3 para. 3 subpara. 1 of the Treaty on European Union (TEU) serves as a point of reference and is the driving force for the related measures laid out in the Treaty on the Functioning of the European Union (TFEU) and to be adopted by the Union, and which shape the internal financial market.[1] Specifically, under Art. 26 para. 2 TFEU the internal market is defined as an area without internal frontiers, calling for the free movement of goods, persons, services and capital. This broad concept includes an internal market in financial services and markets, which is based on the free movement of services

[1] For a brief overview of these cornerstones of market integration see Haar, B. 'European Banking Market' in Basedow, J, Hopt, K and Zimmermann, R (eds), *Max Planck Encyclopedia of European Private Law* (2012) 545-546.

(Art. 56 TFEU), the freedom of establishment (Art. 49 TFEU) and the free movement of capital (Art. 63 TFEU).[2]

It stands to reason that there are various levels at which financial regulation, within the context of integration of Member State markets, faces specific challenges. First of all, there is the obvious need to accommodate cross-border capital flows, and resulting regulatory strategies have to be analyzed in this light (discussed in section 2). It is clear that this accommodation of cross-border capital flows in the EU financial market, and the underlying supervisory arrangements in the Member States, are two sides of the same coin and therefore need some orchestration (see section 3). This orchestration raises questions about the relationship between Member State-based supervision at the national, and supranationally-based supervision at the EU level. At the same time, different possible types of interaction between these supervisory structures and different levels of supervisory arrangements enter into the picture, such as self-regulation- and competition-based market discipline vs. supervisory hierarchies, and multi-lateral institutional structures vs. supervisory colleges respectively. In the aftermath of the financial crisis of 2007-09 an additional layer of necessary orchestration has emerged: an ever-increasing need for over-arching coordination to control systemic risk has become apparent and has led to an enhancement of prudential rules on the way towards a European Banking Union (EBU) (discussed in section 4). At the same time, the banking and sovereign debt crisis has made clear the remaining obstacles to financial stability, and to the functioning of financing mechanisms in the euro zone, and more generally to trust towards a stable future for the European Monetary Union, which have made integration by convergence in a Banking Union an even more important and challenging concern.

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[2] For the foundation of the internal market in securities and investment services in the Treaty free-movement guarantees see Moloney, N, *EC Securities Regulation* (2008) 6-8.

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2. The need to accommodate cross-border capital flows and regulatory strategies

The integration of the EU financial market has been based on the idea of the EU internal market, and initially focused on issuers' interest in satisfying their financing needs cross-border.[3] Therefore in the banking sector, for example, the First Council Directive on the coordination of banking law of 1977[4] aimed at harmonizing the rules governing the licensing and supervision of credit institutions which were operating throughout Europe. This coordination-based approach changed fundamentally after the ground-breaking decision of the European Court of Justice in *Cassis de Dijon*[5] to a 'home control' approach. After the European Commission's related subsequent publication of its White Paper on the internal market in 1985, financial regulation was based on the principle of mutual recognition and home control, implying the adequacy of the laws of each of the Member States regarding financial regulation, and requiring them, subject to minimum harmonized standards being adopted at EU-level to restrict free movement only where explicitly permitted in the EC Treaty or where justified by the general good.[6] This mutual recognition approach was extended further, in the banking field, to the grant of a full-fledged European regulatory

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[3] For a division of the history of EU financial regulation into different phases according to regulatory focus cf. Moloney, ibid 11-16.

[4] First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions [1977] OJ L 322/30.

[5] Case 120/78 *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

[6] EC Commission, *Completing the Internal Market*, White Paper from the Commission to the European Council, COM (1985) 310 final.

'passport' by the Second Council Directive on the coordination of banking law of 1989[7]. On the basis of this single passport credit institutions domiciled in an EU Member State are permitted to do business in any other EU Member State without an additional official authorization from the latter's regulator, so that the authorization from the home state serves as a 'passport' to carry on business throughout the EU.

Together with the principle of home country control in the financial services and markets sector, the harmonization of substantive laws of the Member States in the relevant areas was considered a necessary foundation for mutual recognition and the implicit free market access by financial actors. Therefore the Second Banking Directive was supplemented by the Own Funds Directive (Dir 89/299) as well as the Solvency Directive (Dir 1989/647), which for banking operations in the Member States required certain financial ressources or a predetermined ratio between assets and off-balance sheet activities respectively.

The adoption of the collective-investment scheme regime by 1985 went even further to regulate market-access according to the concept of mutual recognition. The UCITS Directive of 1985 regulated the UCITS (undertakings for collective investment in transferable securities) product with a view to liberalization and free cross-border capital flows.[8] Hand in

[7] Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC [1989] OJ L 386/1.

[8] Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [1985] OJ L 375/3, as amended by Directive 2001/107/EC of 21 January 2002 [2002] OJ L 41/20, Directive 2001/108/EC of 21 January 2002 [2002] OJ L 41/35 (UCITS III), and as replaced subsequently by Directive 2009/65/EC of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities [2009] OJ L 32 (UCITS IV). For the most recent 'UCITS V' reform, as agreed on by the European Council and the European Parliament see Position of the

hand with this objective goes its reliance on minimum harmonization of investor protection rules and the provision of a regulatory passport; this approach has prevailed in the investment services/asset management sector generally ever since and ultimately led to the extension of these rules by the Alternative Investment Fund Managers Directive to alternative investment fund managers in the aftermath of the financial crisis of 2007-09.[9]

At the same time, the idea of mutual recognition was carried over to the field of issuer disclosure harmonization, in relation to which it was guided by the goal to secure market access for issuers on the basis of harmonized disclosure rules. That is why the original 1980 Listing Particulars Directive imposed certain minimum substantive requirements regarding the information to be disclosed with respect to the issuer of the offered securities and the attributes of the offered securities in the document required on admission to a stock exchange and made arrangements to provide for the approval of the listing particulars prior to the listing of the security on an official exchange.[10] On the same premise of mutual recognition, the 1989

European Parliament adopted at first reading on 15 April 2014 with a view to the adoption of Directive 2014/…/EU of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities [2009] OJ L 32 (UCITS) as regards depositary functions, remuneration policies and sanctions (COM(2012)0350 – C7-0178/2012 – 2012/168(COD)) (download at http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2013-0309&language=EN&ring=A7-2013-0125. For the most recent 'UCITS VI' consultation, launched in July 2012, on UCITS product rules, extraordinary liquidity management tools, depositary passport, money market funds and long-term investments see . http://ec.europa.eu/internal_market/consultations/2012/ucits_en.htm.

[9] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No. 1095/2010 [2011] OJ L 174/1

[10] Directive 80/390/EEC of 17 March 1980 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

Public Offering Directive imposed certain minimum substantive requirements regarding the information to be disclosed in the prospectus to be provided on a public offer of securities with respect to the issuer of the offered securities and the attributes of the offered securities, as well as certain minimum requirements regarding the communication of the prospectus to the competent authorities or national regulators and the distribution of the prospectus.[11]

However, as a precondition for approval, the competent authorities of the Member States could require that the listing particulars or the prospectus be supplemented to include information specific to their respective markets in which the securities were to be listed or offered, e.g., the income tax system, the ways in which notices to investors were to be published.[12] Therefore, the scope of the mutual recognition regime for issuers was limited at this stage, but would be enlarged later on by the 2003 Prospectus Directive.[13]

These limitations on mutual recognition came to light even more clearly in the subsequent Investment Services Directive of 1993 (ISD) that was based on the idea of an investment services passport and the related principle of home country supervision of investment

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listing [1980] OJ L66/21 (LPD) Art. 4-23 (repealed by Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities).

[11] Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public [1989] OJ L124/8 (POD, repealed by Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64).

[12] LPD, n 10 above, Art. 24a, 24b; POD, n 11 above, Art. 21.

[13] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive) [2003] OJ L 345/64. For details see below.

services.[14] By contrast with the Listing Particulars Directive and the Public Offering Directive, the ISD was very clearly geared towards investment firms and their activities, but not so much towards investor protection.[15] As the Second Banking Directive had only covered credit institutions where they operated as universal banks in that the Directive covered investment services activities but only where carried out by a deposit-taking institution, the ISD focussed on investment firms.[16] Therefore it included rules addressing the harmonization of authorization conditions and of prudential supervision to secure the foundation for home state control and mutual recognition. But at the same time, the objective of free cross-border provision of services gave rise to national product-oriented rules, the harmonization of which was far from complete. As a result, Member States had considerable leeway to apply the "general good" exception and thereby to dilute the free provision of services and the related passport principle by applying national product-oriented rules.[17] This is exemplified particularly clearly by Article 11 of the ISD which provided for minimal harmonization of

[14] Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (Investment Services Directive or ISD) [1993] OJ L141/27 (repealed by Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments [2004] OJ L 145/1).

[15] Moloney, n 2 above, 567.

[16] Second Council Directive 89/646/EEC, n 8 above, Art. 1 No. 1 referring to First Council Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions, OJ L 322/30, 17.12.1977, Art. 1 (a 'credit institution' means an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account…) Since repealed by Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions [2000] OJ L 126/1).

[17] With reference to the underlying "dilemma" between divergent national standards of investor protection and the free circulation of goods and services see Köndgen, J, 'Rules of Conduct: Further Harmonisation?' in Ferrarini, G (ed), *European Securities Markets; The Investment Services Directive and Beyond* (2006) 115, 129.

conduct of business principles, leading to widely varying regimes in the Member States.[18] Besides these loopholes for Member State involvement in the field of conduct of business rules created by Art. 11, an additional weakening of the market-integration mechanism of the ISD was brought about by Articles 17 para. 4 and 18 para. 2. These provisions allowed 'host' country authorities, the authorities of the Member States in which the cross-border activity took place, to impose additional conditions on another Member State's investment firm in the interest of the general good.[19]

In light of these shortcomings with respect to the achievement of market integration under the ISD in particular, the Financial Services Action Plan (FSAP), issued by the European Commission at the turn of the century, marked the beginning of a new period of regulatory policy in the financial sector.[20] With the FSAP, the Commission aimed at the completion of market-integration, by adopting 42 measures targeted at retail markets, wholesale markets, prudential rules and supervision, and conditions for an optimal single financial market. With

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[18] Haar, B, 'From Public Law to Private Law: Market Supervision and Contract Law Standards' in Grundmann, S and Atamar, Y (eds.), *Financial Services, Financial Crisis and General European Contract Law; Failures and Challenges of Contracting* (2011) 262-263. For an overview of conduct of business rules and their implementation under the ISD see Tison, M, 'Conduct of Business Rules and their Implementation in the EU Member States' in Ferrarini, G, Hopt, K and Wymeersch, E (eds.), *Capital Markets in the Age of the Euro; Cross-Border Transactions, Listed Companies and Regulation* (2002) 65-99. For the wide variation of conduct rules see European Commission, The Application of Conduct of Business Rules under Article 11 of the Investment Services Directive (93/22/EEC), Brussels, 14.11.2000, COM (2000) 722 final (for details on this communication cf. Moloney, n 2 above, 387-389).

[19] Pointed out as an "important aspect" by Ferrarini, G. 'Towards a European Law of Investment Services and Institutions (1994) 31 *Common Market Law Review* 1283, 1297.

[20] European Commission, Financial Services: Building a Framework for Action, COM (1998) 625 final, Brussels, 28.10.1998 (followed by European Commission, Implementing the Framework for Financial Markets: Action Plan (FSAP), Brussels, 11.5.1999, COM (1999) 232 final.

respect to the last objective, the reforms extended to the regulation of Alternative Trading Systems (ATS), the management of conflicts of interest and the handling and execution of client orders by investment intermediaries, the periodic and continuous disclosures by issuers of listed securities, the prohibition of market manipulation, the production and dissemination of investment recommendations, and the stabilization of new issues and share buy backs. Such an extension of regulation necessarily marked a significant increase in the range and sophistication of EU financial regulation.

How the resulting regulation of markets, such as exchanges, market players, especially investment firms, and market activities, in particular investment services, became intertwined is very well exemplified by the 2004 Markets in Financial Instruments Directive (MiFID I), which replaced the ISD in the aftermath of the FSAP.[21] By comparison with the ISD, MiFID I adopts a broader perspective. As a result, it covers the full range of areas related to investment services, such as the organizational requirements for firms and markets, conduct of business requirements for firms, transaction reporting to relevant competent authorities of buy and sell transactions in all financial instruments, and transparency requirements for the trading of shares. This much greater scope of regulation by MiFID I was designed to promote market integration in several respects. For example, by subjecting trading venues in the form multilateral trading facilities (MTFs) to similar transparency requirements as those which apply to exchanges and at the same time, exposing exchanges to competition from MTFs, MiFID I facilitates a level playing field between exchanges and other markets.

[21] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments [2004] OJ L 145/1. For a detailed overview see Casey, J-P and Lannoo, K, *The MiFID Revolution* (2009); Moloney, n 2 above, 356-378, 392-522, 591-642; and, with a focus on investor protection, see Moloney, N, *How to Protect Investors; Lessons from the EC and the UK* (2010) 192-288 and passim.

In particular, MiFID I establishes a framework for the authorization[22], regulation, and supervision[23] of financial exchanges in the EU, which is further amplified under the 'Lamfalussy process' for delegated/administrative rule-making (discussed in section 3) by detailed 'level 2' rules adopted as a technical implementation measure by the Commission and based on mandates in the pertinent 'level 1' measure, which can be either a directive or a regulation, adopted by the Council and Parliament[24] These level 2 rules form a suitable basis for a more effective passport regime under MiFID I.[25] Finally MiFID I governs trade execution by investment firms, providing for a new regime of "best execution" rules, thus taking another step towards maximum harmonization in a field traditionally regulated by the Member States.[26]

MiFID I also addresses investor protection, deploying a three-pronged strategy to tackle investor protection, in particular by prescribing organizational requirements for the marketplace, by ensuring market integrity by way of transparency rules and by providing for an EU-wide conduct of business regime.[27]

As far as the regulation of trading is concerned, and with respect to market integration in particular, MiFID I does away with 'concentration' rules, which require the routing of orders

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[22] Art. 36 para. 1.

[23] Art. 37-39.

[24] For further details cf. Moloney, n 2 above, 406, 592.

[25] For an overview of level 2 measures under MiFID I see Ryan, J, 'An Overview of MiFID' in Skinner, C (ed), *The Future of Investing In Europe's Markets after MiFID* (2007) 13, 15-16.

[26] For details on these rules cf. Kirby, A. 'Best Execution' in Skinner, ibid () 31-63 and Casey and Lannoo, n 21 above, 58-77.

[27] For a concise overview of the objectives of MiFID I see Avgouleas, E, 'A Critical Evaluation of the New EC Financial-Market Regulation: Peaks, Troughs, and the Road Ahead' (2005) 18 *The Transnational Lawyer* 179, 191-197.

to a stock exchange, so that Member States must allow internalization of orders or the execution of orders by firms against their proprietary order books and can no longer restrict the routing of orders to stock exchanges, but must permit execution by MTFs or through the investment firms themselves.[28] This requirement is designed to increase competition in trading.[29] Given the elimination of the concentration rule, and the resulting increase in competition, pre- and post-trade transparency obligations are also imposed under MiFID I and aim to further ensure the effectiveness of EU trading markets .[30] Pre-trade transparency rules accordingly extend to 'systematic internalisers', i.e. investment firms which on an organized, frequent and systematic basis, deal on own accounts by executing client orders outside a regulated market or an MTF, requiring them to publish quotes for liquid shares.[31] Post-trade transparency rules apply to all venues and investment firms and govern the obligation to publish data on concluded trades.[32] Furthermore, a transaction reporting regime requires the reporting of transactions traded on prescribed non-regulated markets and of

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[28] MiFID I, Art. 22. For a detailed analysis of the internalization of trading orders under the MiFID see Ferrarini, G and Recine, F 'The MiFID and Internalisation' in Ferrarini G and Wymeersch, E (eds), *Investor Protection in Europe. Corporate Law Making, the MiFID and Beyond* (2006) 235-270.

[29] For the goal of competition in the MiFID I see MiFID I recitals 34, 47, and 48. For further implications of MiFID I with respect the exchanges and MTFs see Webb, S, 'Exchanges, MTF's, Systematic Internalisers and Data Providers – Winners and Losers in a Post-MiFID World' in Skinner, n 25 above,) 151-170.

[30] On the significance of price transparency see Casey and Lannoo, n 21 above, 43-44.

[31] For the meaning of 'systemic internalisers' see Art. 4 no. 7 of MiFID I; for the pre-trade transparency requirements for MTFs Art. 29 MiFID I; for details on the pre-trade transparency rules see Moloney, n 2 above, 824-827, 829-836

[32] For post-trade transparency requirements for MTFs see MiFID I, Art. 30; for details see Moloney, ibid 824-825, 827-828, 836-837.

transactions in over-the-counter instruments that are related to instrument on prescribed markets.[33]

Besides trading transparency rules, MiFID I establishes an extensive conduct of business regime in order to enhance investor protection. This regime addresses, inter alia, aspects of client classification, suitability and appropriateness issues, and questions of 'best execution' and of client order handling.[34] The most important client classification underlying the MiFID I regime is the distinction between retail clients, professional clients and eligible counterparties, as specified in Annex II of the Directive, that aims to provide investor protection rules suited to the needs of the respective category of investors.[35] Hand in hand with the classification of investors go harmonized client protection requirements, resulting from detailed provisions governing the assessment of a client's classification, as laid out in MiFID I, Art. 19 and in Art. 28 of the related Level 2 Directive[36]. The underlying suitability and appropriateness tests, for example, are part of the 'know your customer' regime which applies under MiFID I. Suitability testing is required for advised services and portfolio management in order to ensure the suitability of the advice or the product with respect to the client's expertise, risk profile and financial situation.[37] In contrast, the appropriateness

[33] For the underlying obligation to uphold the integrity of markets, report transactions and maintain records see MiFID I, Art. 25; for further information see Ryan, n 25 above, 26-27.

[34] MiFID I, Art. 19, 21, 22.

[35] For details see Smith, D and Leggett, S, 'Client Classification' in Skinner, n 25 above, 65-73.

[36] Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2006] OJ L 241/26.

[37] For the requirement of suitability testing see MiFID I, Art. 19 para. 4; for the criteria in detail cf. Commission Directive 2006/73/EC, n 35 above, Art. 35, [2006] OJ L 241/26, 50 and for an overview of the suitability assessment see Smith and Leggett, n 34 above, 68-69.

assessment applies to non-advised services, requiring an assessment of whether the client has the necessary knowledge and experience in the relevant investment to understand the risks involved.[38] By contrast with the suitability test, the investment firm is not precluded from supplying the service, if it does not receive the necessary information from the client provided it warns the client.[39]

Satisfying the client classification requirements lays the basis for the fulfilment of the standard of best execution under MiFID I, Art. 21. The MiFID I best execution regime is laid down in Art. 21 and is part of the wider MiFID I conduct-of-business regime. According to MiFID, Art. 21 para. 1, in order to satisfy this standard, investment firms must follow the goal of value maximization for their customers, but in light of constraints such as the latter's investment objectives.[40] Therefore, best execution is necessarily characterized by a high degree of flexibility because, depending on the client, a variety of factors such as transaction costs, and the speed and likelihood of execution and settlement may enter into the best execution assessment.[41] At this point, the underlying suitability and the appropriateness tests play out in favour of the investment firms, because compliance with these requirements proves that an order is executed in the manner most favourable for a particular client.[42] This approach in turn explains why client classification is a relevant factor to determine best execution.[43] Closely connected with the standard of best execution are the client order

[38] For the requirement of an appropriateness assessment see MiFID I, Art. 19 para. 5.

[39] MiFID I, Art. 19 para. 5 subpara. 2; for details on the appropriateness assessment see Casey and Lannoo, n 21 above, 49-53.

[40] Ibid,, 41.

[41] For the factors to be taken into account for the best execution assessment see MiFID, Art. 21 para. 1; specifying the flexibility of this approach see, Moloney, n 2 above, 623-628.

[42] MiFID I, Art. 21 para. 1 and 2; for the related proof requirements see Avgouleas, n 27 above, 195.

[43] Kirby, n 26 above, 42-45.

handling rules under MiFID I, Art. 22 which require investment firms to execute client orders quickly and accurately.[44]

Overall, therefore, the harmonized investor protection regime under MiFID I, as just described, complements the MiFID I passporting system, in order to further cross-border capital flows, thus supporting the internal market. In addition, the regulation of the marketplace, along with the elimination of the concentration rule mentioned above, similarly ensures access for firms to certain trading markets and to clearing and settlement systems.[45] Hand in hand with this free market access goes a level playing field for investment firms across Europe, thanks to the harmonized conduct of business regime under MiFID I. Since host countries cannot impose additional requirements in this respect, investment firms are bound by their home country's regime.[46] The conduct of business rules under MiFID I thus ensure a high degree of harmonisation, facilitating cross-border activities.[47] In this way MiFID I provides for a substantially new level of sophistication of EU financial regulation to support home Member State control. As new regulatory challenges have become apparent throughout the recent financial crisis, though, the MiFID I regime is being reformed, as discussed further below.

The FSAP's harmonization and liberalization strategy can be further illustrated by the Prospectus Directive of 2003[48] and by the Market Abuse Directive of 2003[49], which can both

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[44] Ryan, n 25 above, 23.

[45] For these access rules see MiFID, Art. 33, 34, 42); Casey and Lannoo, n 21 above, 192-193.

[46] MiFID I, Art. 31 para. 1 subpara. 2, 32 para. 1 subpara. 2.

[47] Moloney, n 2 above, 594-595.

[48] Prospectus Directive 2003/71/EC, n 13 above.

[49] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (Market Abuse Directive) [2003] OJ L 96/16.

be characterized as successful FSAP measures.[50] The Prospectus Directive saw the EU passport concept being deployed for the first time in the issuer disclosure field of regulation, such that a prospectus, once approved in one European Member State will now be recognised Europe-wide. This follows from the issuers' obligation to seek approval of the prospectus from the competent authority of the home Member State before its publication (Prospectus Directive, Art. 13 para. 1) and to subsequently file it with this authority (Prospectus Directive, Art. 14 para. 1). Closely connected with the adoption of the home country principle, the high degree of harmonization of prospectus requirements may justify the classification of the Prospectus Directive as being of a 'maximum harmonization' nature in that it removes all Member State regulatory discretion.[51] Deploying a maximum harmonization approach supports mutual recognition but also support another principal aim of the Prospectus Directive to take hold effectively, that is the goal of retail investor protection.[52] The Directive's orientation towards retail investors is reflected in particular by the issuer's obligation to provide a prospectus summary that must inform the investors about the essential characteristics and risks associated with the issuer, any guarantor and the securities in brief and non-technical form.[53] Somewhat related to the evolution of the prospectus regime, harmonized disclosure reforms with regard to financial reporting requirements, and especially

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[50] For the positioning of these directives in the FSAP context see Moloney, n 2 above, 114-117, 915.

[51] See further Moloney, n 2 above, 114; Schammo, P, *EU Prospectus Law* (2011) 70-74; Tison, M, 'Financial market integration in the post FSAP era – In search of overall conceptual consistency in the regulatory framework' in Ferrarini, G. and Wymeersch, E. (eds), *Investor Protection in Europe – Corporate Law*; and Ferran, E. *Building an EU Securities Market* (2004) 138, 142-144.

[52] Recital 19 Prospectus Directive, n 13 above, [2003] OJ L 345/64, 65.

[53] Prospectus Directive, Art. 5 para. 2; for details on the concept of prospectus summaries see Schammo, n 48 above, 99-101.

under the 2004 Transparency Directive,[54] were also adopted in support of investor confidence, and require accurate and comprehensive ongoing issuer disclosure, thus enhancing market efficiency.[55] Therefore, investor protection and market efficiency appear as two sides of the same coin in the EU's regime for supporting financial market integration.

This close interdependence between market efficiency and investor confidence in the EU's programme for integrating and regulating markets also becomes apparent in the regulatory design of the FSAP's 2003 Market Abuse Directive[56] which seeks to support the efficiency of the price formation process in the capital market. In the case of the Market Abuse Directive, this policy willingness to intervene to support market efficiency shows itself by the market-driven rationale which drives the insider-dealing regime. According to the European Court of Justice, the Directive takes the extent to which inside information might impact on price movements as a guideline for its materiality.[57] In a more straightforward way, the definition of market manipulation under the Market Abuse Directive applies to '…transactions or orders to trade which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of financial instruments, or which secure, by a person, or persons acting in collaboration, the price of one or several financial instruments at an abnormal or artificial

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[54] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonization of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive) [2004] OJ L 390/38.

[55] Recital 1, Transparency Directive, ibid.

[56] E.g. Recitals 2, 12 and 24, Market Abuse Directive, n 49 above.

[57] Judgment of the Court of 10 May 2007, Case C-391/04 *Oikonomikon and Amfissas v. Georgakis* [2007] ECR I-3741, I-3770-3771. For an overview see Avgouleas, E, *The Mechanics and Regulation of Markets Abuse, A Legal and Economic Analysis* (2005) 75-101, 156-234. With specific reference to the CESR approach, see Moloney, n 2 above, 936-937.

level', thus requiring a quite direct interference with the price formation process.[58] Further instances of market manipulation under the Directive such as the employment of 'fictitious devices or any other form of deception or contrivance' and the dissemination of information through the media…, which gives…, false or misleading signals as to financial instruments…' have the same effect.[59] On the other hand, the regulatory design of the Market Abuse Directive differs from that of the Prospectus Directive because in addition to the insider prohibition, it also provides for disclosure duties for issuers of listed financial instruments, in order to ensure the publication of any inside information as soon as possible.[60] In light of this latter objective, the Directive goes into more detail, including the duty to keep updated lists of insiders.[61]

Despite these specifications, the regulatory design of the Market Abuse Directive does not amount to a maximum harmonization approach, but instead can be characterized as a minimum harmonization measure.[62] This regime, however, is undergoing substantial changes in this respect, as an agreement on a new market abuse regulation was reached in 2013, which is designed to tackle insider dealing and market manipulation.[63] It will replace the existing Market Abuse Directive, and will be complemented by the proposed directive on criminal

[58] Market Abuse Directive, n 49 above, Art. 1 no. 2 a.

[59] For these definitions of market manipulation see Market Abuse Directive, n 49 above, Art. 1 no. 2 b and c; for a detailed analysis of the different types of market manipulations see Avgouleas, n 54 above, 103-154.

[60] Market Abuse Directive, n 49 above, Art. 6 para. 1; for a detailed comparison see Enriques, L. and Gatti, M. 'Is There a Uniform EU Securities Law After the Financial Services Action Plan?' [2008] 14 *Stanford Journal of Law, Business & Finance* 43, 54-63, 71-72.

[61] Market Abuse Directive, Art. 6 para. 3.

[62] Enriques and Gatti, ibid, 72; Moloney, n 2 above, 916-917; and, highlighting the ambivalence in this area see Gerner-Beuerle, C. 'United in diversity: maximum versus minimum harmonisation in EU securities regulation' (2012) 7 *Capital Markets Law Journal* 317, 328.

[63] Council of the European Union, Interinstitutional File: 2011/0295(COD), Brussels, 25 June, 2013.

sanctions for market abuse[64]. In light of its high degree of specification, it can be considered as an important step towards the post-crisis 'single rulebook' as envisioned among others by the European Securities Markets Authority (ESMA) (discussed in section 3) in its work programme[65]. Apart from the harmonization of substantive legal rules, one has to note, though, that the enforcement of the market abuse regime currently in force is left to the Member States, so that there is some room for divergence. Given the resulting importance of the enforcement stage for the ultimate success of regulatory harmonization, it comes as no surprise that the Market Abuse Directive follows enforcement strategies across different levels and actually was the first FSAP measure to implement the Lamfalussy model. Therefore, it represents the harmonization strategy of the FSAP, which relied on more detailed regulation without however breaking the link to home Member State control.

At the same time, the resulting divergences of the implementation on the Member State level made apparent the limits of the FSAP. Despite accelerating the harmonization process, it did not succeed in reaching complete regulatory convergence of national financial regulation. Instead, "excessive divergence" was found to be one of the driving forces behind the global financial crisis by the De Larosière Group.[66] Hence it seems natural to move to the single rulebook over the crisis era in order to avoid the tension between financial stability, financial integration and national financial policies.

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[64] Regulation (EU) No. 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing directive 2003/6/EC of the European Parliament and of the Council and Commission directives 2003/124/EC, 2003/125/EC and 2004/72/EC [2014] OJ L 173/1.

[65] ESMA, 2012 *Work Programme* 4.

[66] *The High Level Group on Financial Supervision in the EU*, Report, Brussels, 25 February 2009, 10-11, 28; for the resulting reconceptualization of the internal market in financial services see Moloney, N. 'EU Financial Market Regulation After the Global Financial Crisis: More Europe or More Risks?' [2010] 47 *Common Market Law Review* 1317, 1324.

This shift is reflected by the far -reaching crisis-era initiative under the new MiFID II regime to extend the scope of the existing MiFID I, thus addressing shortcomings that became apparent throughout the financial crisis of 2007-09.[67] In order, for example, to reduce systemic risk, MiFID II aims to extend the scope of MiFID I to more firms and to additional instruments, as well as to electronic trading.[68] To further enhance market integrity, for example, it includes provisions on additional transparency requirements and transaction reports, and on third country firms seeking to access the market.[69] Issues of investor protection and related inducements are also addressed.[70] Finally, a new product intervention regime is provided for, to be deployed by national regulators in coordination with ESMA. This last point is in fact well-suited to highlight another key dimension of EU financial regulation, that is the orchestration of different supervisory arrangements and the coordination of Member State-based supervision at the national level and supranational supervision at the EU level supervision (as discussed in section 3 below) .

These recent developments throw a light on the fundamental change the harmonization process has undergone throughout its evolution since its beginning in the era of the "approximation of laws" under TFEU Art. 114 with the focus on cross-border capital flows and the resulting better functioning of the internal market. The FSAP at the end of the 1990s was designed to give further impetus to this harmonization process on the basis of more detailed regulation, but adhered to Member State control with respect to implementation. This imbalance was recognized as a contributing cause of the global financial crisis and resulted in a shift towards a single rule-book that aims at a farther-reaching uniformity that includes

[67] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II) [2014] OJ 173/349.

[68] MiFID II, n 67 above, Art. 17.

[69] MiFID II, n 67 above, Art. 39-44.

[70] MiFID II, n 67 above, Art. 24-29.

directives, regulations, implementing acts, standards, guidance, and other similar non binding instruments.[71]

3. Orchestration of the underlying institutional arrangements

The need for coordination of Member State-based supervision and regulation had become apparent from an early stage in the investment-services area, for example, through the implementation of the '… general presumption in favour of the free provision of services on the basis of home country authorization'[72] under the 1993 ISD. As mentioned above (in section 1), ISD, Art. 17 para. 4 and 18 para. 2 offered, however, the possibility to host country authorities to bring to bear rules of conduct to be complied with in the interest of the general good on passporting investment firms.[73] After having received notification from a Member State's investment firm wishing to establish a branch within their territory, host country authorities had the obligation to indicate '… the conditions, including the rules of conduct, with which, in the interest of the general good, the providers of the investment services in question must comply in the host Member State…'[74]. It goes without saying that only limited

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[71] Gurlit, E, 'The ECB's Relationship to the EBA' (2014) 25 *Europäische Zeitschrift für Wirtschaftsrecht* 14, 16-17; Moloney, N. 'EU Financial Market Regulation After the Global Financial Crisis: More Europe or More Risks?' [2010] 47 *Common Market Law Review* 1317, 1326.

[72] Commission Communication on The Application of Conduct of Business Rules under Article 11 of the Investment Services Directive, COM (2000) 722, p. 14.

[73] Commission Communication on The Application of Conduct of Business Rules under Article 11 of the Investment Services Directive, COM (2000) 722, p. 14; for the regulatory context see Ferrarini, G, 'Contract Standards and the Markets in Financial Instruments Directive. An Assessment of the Lamfalussy Regulatory Architecture' (2005) 1 *European Review of Contract Law* 19, 23-25.

[74] Art. 18 para. 2 of the ISD, n 14 above.

harmonization could follow from this approach to rules of conduct. At the same time, however, the market-enhancing effect of the ISD's home control regulatory strategy is quite obvious. By introducing a single licence for investment intermediaries, the ISD reduced market barriers considerably, so that the empirical findings indicating changes towards a market-based system in the European financial system were not surprising as the market enabling dimension of the ISD became apparent.[75]

At the same time, home country control results in Member States' dependence on the quality of each other's regulation and supervision. Therefore one can expect a relationship between the need for supervisory/regulatory institutional orchestration and the stage of harmonization. Accordingly, it was the implementation of the ambitious FSAP, which sought further market-integration, that called for the further development of the regulatory process in the European Union through institutional reform. The vast number of measures to be adopted under the FSAP required an improved rule-making process to meet efficiency concerns.[76] Under the subsequently introduced so-called Lamfalussy process, based on the 2001 Final Report of the Committee of the Wise Men, the creation of EU financial markets legislation is divided among different EU bodies according to different levels of specification.[77]

The entire procedure is based on the foundation 'level-1' legislation setting out broad framework principles for legislation and agreed on at the EU level according to established law-making procedures.[78] In the interests of a fast legislative procedure, the Lamfalussy

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[75] Casey and Lannoo, n 21 above, 26.

[76] Committee of Wise Men on the Regulation of European Securities Markets, Final Report (Brussels, 15 February 2001) (Lamfalussy Report) p. 10-12.

[77] Lamfalussy Report, ibid, p. 19-42; cf. for a detailed overview Ferran, n 51 above, 61-67.

[78] Lamfalussy Report, n 76 above, p. 19 and 27; Ferran, n 51 above, 62; and, for an extensive analysis of level-1 legislation and its evolution, Moloney, n 2 above, 1031-1048.

Report encouraged greater use of regulations, which are binding and directly applicable in all Member States, as opposed to directives, whose implementation by national authorities could, argued the Report, take up to eighteen months.[79] 'Level-2' rules are implementing measures, whose scope has been defined in level-1 acts and which are adopted through 'comitology' procedures (in effect, the rules are adopted by the Commission)'.[80] Framework principles at level-1 and implementing measures at level-2, of course, easily merge into one another, thus jeopardising a clear-cut orchestration of rule-making and supervision, as can become apparent from 'parallel working' on level 1 and level 2 measures, where both forms of measure are negotiated at the same time.[81] But in principle, under the Lamfalussy process, implementing measures were characterized by the delegation of law-making functions to the Commission and a modified comitology procedure, the so-called Lamfalussy process (, which has since been modified following the establishment of the European Supervisory Authorities in the wake of the financial crisis). Under the original procedure, and with respect to securities market rule-making, the Commission, assisted by the then newly established comitology committees, the political European Securities Committee (ESC), which exercised a primarily oversight function but could lead to the Council blocking the delegated measure[82] and the national-regulator-based Committee of European Securities Regulators (CESR), which

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[79] Lamfalussy Report, n 76 above, p. 26.

[80] For a closer analysis of level-2 legislation and its underlying procedure cf. Moloney, n 2 above, 1048-1080 and, with reference to the Market Abuse Directive, Ferran, n 51 above, 81.

[81] For scepticism with regard to the distinction between framework principles at level-1 and level-2 measures see Ferrarini, n 66 above, 28-29. For a criticism of the resulting complexity of the regulatory structure see Moellers, T, 'Sources of Law in European Securities Regulation – Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to de Larosière' (2010) 11 *European Business Organization Law Review* 379, 383.

[82] Art 2 b and 5, Council Decision 99/468/EC laying down the procedures for the exercise of implementing powers conferred on the Commission (1999) OJ L184/23. See further Ferran, n 51 above, 77 and Moloney, n 2 above, 1049-1050.

exercised advisory functions[83], could adopt delegated/secondary legislation.[84] By 2003 these committees were complemented by the political European Banking Committee (EBC)[85] and the European Insurance and Occupational Pensions Committee (EIOPC)[86] and by equivalent advisory committees in the banking and insurance/occupational pensions spheres.

In addition to level 2 rule-making, under the rule-making model which followed the 2001 Lamfalussy Report, level-3 measures were also adopted in order to support implementation of level 1 and 2 rules at the national level. Level 3 was designed to support enhanced and strengthened cooperation between national regulators and to deliver a consistent and equivalent implementation of level-1 and level-2 legislation at the Member State level.[87] Level 3 was primarily supported by cooperation through CESR and its partner advisory committees, the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). They issued, at level 3, guidelines for national implementation in order to set best practices, formulate joint interpretative recommendations and standards for matters not covered by EU law, and

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[83] Lamfalussy Report, n 76 above, p. 28. For further details on these committees cf. Ferran, n 51 above, 77-80. For more details on CESR see Ferran, E, 'Understanding the New Institutional Architecture of EU Financial Market Supervision' in Wymeersch, E, Hopt, K and Ferrarini, G (eds), *Financial Regulation and Supervision; A Post-Crisis Analysis* (2012) 111, 116-125.

[84] Lamfalussy Report, n 76 above, p. 28-36; Commission Decision 2001/527/EC establishing the Committee of European Securities Regulators (2001) OJ L191/43 (revised in 2009: Commission Decision 2009/77/EC establishing the committee of European Securities Regulators [2009] OJ L25/23).

[85] Commission Decision 2004/10/EC of 5 November 2003 establishing the European Banking Committee (2004) OJ L003/36. For more details on CEBS see Ferran, n 83 above, 125-129.

[86] Commission Decision 2004/9/EC of 5 November 2003 establishing the European Insurance and Occupational Pensions Committee (2004) OJ L003/34; for more details on CEIOPS cf. Ferran, n 83 above, 130.

[87] Lamfalussy Report, n 76 above, p. 37.

conduct peer reviews[88], although these advisory committees did not have any rule-making powers.[89] The four-level regulatory approach following the Lamfalussy report was completed by level 4, which focused on the enforcement of EU law. According to the Lamfalussy Report, the primary responsibility for this task was to lie with the Commission, which was to be assisted helped by the Member States, their regulators, the private sector, and the European Parliament.[90] Broadly speaking, despite the groundbreaking post-crisis institutional reform of the structure of EU financial market supervision as discussed under section 4., the newly established supervisory authorities basically operate on the basis of the four level organization approach just described. At the same time these increasingly important new European Supervisory Authorities considerably enhance the latter's institutional profile.[91]

While the Lamfalussy model enhanced rule-making by the EU, difficulties remained. In particular, the centralization and coordination of rule-making procedures under the Lamfalussy model, on the one hand, and the location of supervision at the Member State level on the other suggested a need for further supervisory coordination, and resulted in corresponding proposals in practice and among scholars.[92] The related shortcomings of EU financial regulation and supervision became particularly apparent in the wake of the recent financial crisis 2007-09 and were expressed in the 2009 de Larosière Report, published by the

[88] Lamfalussy Report, n 76 above, p. 37.

[89] For a detailed overview of the CESR cf. Ferran, n 83 above, 116-125.

[90] Lamfalussy Report, n 76 above, p. 40; for an analysis cf. Moloney, n 2 above, 1081-1085.

[91] On the nexus between the Lamfalussy Level 3 Committees and the European Supervisory Authorities see Ferran, E, n 83 above, 130-138, 144-146.

[92] See e.g. the so-called Himalaya Report of the CESR (CESR, *Which Supervisory Tools for the EU Securities Markets* [CESR/04-333f]), October 2004; Centre for European Policy Studies (CEPS), *Concrete Steps Towards More Integrated Financial Oversight,* December 2008;and, indicating the potential 'mismatch' between rule-making and supervision, Ferran, n 51 above, 123-124.

High Level Group at the request of the European Commission.[93] First and foremost, a major weakness of the regulatory system became apparent in the form of its focus on microprudential regulation, and its failure to address macroprudential risks and to focus on systemic stability.[94] In addition, the de Larosière Group identified problems of competences in supervisory oversight at the Member State level and failures to challenge supervisory practices on a cross-border basis, and a resulting lack of coordination in supervising cross-border groups, so that significant risks created by home supervisors were borne by host countries (summarised in the slogan that is generally attributed to Mervyn King 'Banks are international in life but national in death').[95] These factors contributed to the risks to the EU internal financial market resulting from excessive leverage taken on by banks which were not subject to a sufficiently strict and effective prudential oversight.

4. Two-tier financial oversight to control systemic risk

Therefore the financial crisis in the EU highlighted the need to take account of the macroeconomic implications of regulation, and, in particular, to strengthen the prudential regulation of banks accordingly. At the same time, it became clear that, and aside from the increasingly important need to address macroprudential stability, microprudential supervision also had to be reinforced in order to overcome the shortcomings of the Lamfalussy procedure

[93] For a very brief overview see Di Noia, C, and Furlò, M, 'The New Structure of Financial Supervision in Europe: What's Next?' in Wymeersch et al n 83 above) 172, 174-175; Moloney, N, 'Supervision in the Wake of the Financial Crisis: Achieving Effective 'Law in Action' – A Challenge for the EU' in Wymeersch et al n 83 above, 71, 72 and 78-79; Wymeersch, E, 'The European Financial Supervisory Authorities or ESAs' in Wymeersch et al n 83 above, 232, 234.

[94] *The High Level Group on Financial Supervision in the EU*, Report, Brussels, 25 February 2009, 11 and 39-40.

[95] Ibid, 40-41. For details on the lack of cross-border supervision throughout the crisis see Ferrarini, G and Chiodini, F, 'Nationally Fragmented Supervision over Multinational Banks as a Source of Global Systemic Risk: A Critical Analysis of Recent EU Reforms' in Wymeersch et al n 83 above, 193, 198-202.

discussed in section 3 above and to increase its efficiency. Recognizing this need for a two-tier approach, the European Commission came forward with a proposal in 2009 which suggested that microprudential supervision be strengthened through a European System of Financial Supervision (ESFS),[96] and that a European Systemic Risk Board (ESRB) in charge of macroprudential oversight, be established; this new organizational design was adopted by the Council and European Parliament a year later in 2010.[97]

4.1. Microprudential Supervision by the ESAs

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[96] European Commission, *Proposal for a Regulation of the European Parliament and of the Council on Community macroprudential oversight of the financial system and establishing a European Systemic Risk Board*, COM (2009) 499 final, Brussels, 23.9.2009; European Commission, *Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority*, COM (2009) 501 final, Brussels, 23.9.2009; European Commission, *Proposal for a Regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pensions Authority*, COM (2009) 502 final, Brussels, 23.9.2009; European Commission, *Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority*, COM (2009) 503 final, Brussels, 23.9.2009; and European Commission, *Proposal for a Regulation of the European Parliament and of the Council Amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC, and 2009/65/EC in respect of the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority* ('2010 Omnibus I Directive'), COM (2009) 576 final, Brussels, 26.10.2009.

[97] Regulation (EU) No. 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (2010) OJ L331/1; Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (2010) OJ L 331/12; Regulation (EU) No. 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) (2010) OJ L 331/48; and Regulation (EU) No. 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) (2010) OJ L 331/84; Directive 2010/78/EU [2010 Omnibus I Directive) (2010) OJ L 331/120.

In their report, the High Level Group not only highlighted the above-mentioned shortcomings of financial supervision in the EU as significant factors fostering the financial crisis, but also pointed to the need for institutional reform to overcome the weaknesses that had been standing in the way of the optimum coordination of rule-making procedures at EU-level, and of supervision at the Member State level, and which had resulted in particular in supervisory inefficiencies.[98] These problems are now largely dealt with by the new European Supervisory Authorities (ESAs) which form part of the ESFS along with national competent authorities and the ESRB. Each of them is the successor of a level-3 committee – the European Banking Authority (EBA) (the successor of CEBS), the European Securities and Markets Authority (ESMA) (CESR) and the European Insurance and Occupational Pensions Authority (EIOPA) (CEIOPS).[99] On the basis of their legal personality[100] as well as administrative autonomy the ESAs must, inter alia, improve the functioning of the internal market,[101] support equal conditions of competition,[102] strengthen international supervisory coordination,[103] ensure appropriate regulation and supervision of the taking of investment and other risk.[104]

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[98] Lamfalussy Report, n 76 above, p. 40-41.

[99] For a detailed account of the institutional background see Ferran, n 83 above, 133-138.

[100] Art. 5 para. 1 of the Regulation (EU) 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) (2010) OJ L331/12; Art. 5 (a) of the Regulation (EU) 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) (2010) OJ L331/48; Art. 5 (a) of the Regulation (EU) 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) (2010) OJ L331/84; in the following the context permitting, these three regulations are referred to collectively as 'ESA Regs'.

[101] ESA Regs, n 98 above, Art. 5 para. 1 (a).

[102] ESA Regs, n 98 above, Art. 5 para. 1 (d).

[103] ESA Regs, n 98 above, Art. 5 para. 1 (c).

[104] ESA Regs, n 98 above, Art. 5 para. 1 (e).

Furthermore, ESA Regs, Art. 5 para. 1 (2) calls upon the ESAs to be vigilant with respect to the threat of systemic risk.[105] The governance of the ESAs is characterized by a management board, which is composed of the chairperson and six members and is responsible for the ongoing functioning of the ESA and its compliance with the ESA Regs. or other applicable rules, a Chairperson, an Executive Director, the latter two being full-time professionals, and a Board of Supervisors. In light of the task of the Board of Supervisors to 'give guidance to the work of the Authority' and its status within the ESA as the principal decision making body, the dominant role of the Board of Supervisors is quite clear.[106]

Even though the ESAs do not adopt rules, they support coordination and convergence and are designed to resolve the potential tension between centralized rule-making and local supervision. In order to fulfil this task, they have different instruments at their disposal under the ESA Regulations and the related 2010 Omnibus I Directive.[107]

With respect to supervision, as they have direct supervisory powers to take individual decisions addressed to financial market participants only in some enumerated and exceptional cases (apart from ESMA's direct exclusive supervisory power related to credit rating agencies[108]) noted below, their coordinating powers might be regarded as limited. They have, for example, coordination functions with respect to national supervisors (ESA Regs, Art. 31)

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[105] For the objectives of the ESAs as provided for in ESA Regs, Art. 5 in more detail see Wymeersch n 90 above, , 242-245.

[106] ESA Regs, Art. 43 para. 1; for a more detailed overview ovor the governance structure of the ESAs see Wymeersch, E, n 83 above, 297-311.

[107] For a detailed enumeration see Wymeersch, E, The institutional reforms of the European Financial Supervisory System, an Interim report, Financial Law Institute, Universiteit Gent, 2010, WP 2010-01, p. 11-16.

[108] Regulation (EU) No. 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No. 1060/2009 on credit rating agencies, (2013) OJ L146/1.

as well as within the colleges of supervisors (ESA Regs, Art. 21). In addition, they are to support a common supervisory culture (ESA Regs, Art. 29) and to engage in peer review that aims to assess the implementation of Community rules (ESA Regs, Art. 30) and to foster coordination and convergence of supervisory practices in the EU.[109] Their direct supervisory powers to intervene directly specifically enumerated in the ESA Regs as just mentioned above include the following exceptional cases:[110] In case of a breach of EU law by a national competent authority, the ESAs can direct the latter to comply with EU law.[111] Similarly, in emergency circumstances seriously jeopardising the functioning of financial markets the ESAs can require of the competent national authorities the necessary action to respond to the adverse developments.[112] Their power to settle disagreements between competent authorities in cross-border situations in a binding mediation is a third example of the ESAs' powers that allow them to potentially act in a hierarchical manner in relation to national regulators, which they have, however, not used yet.[113]

Finally, and in support of rule-making, the goal of convergence and improvement of national supervision in a functioning internal market, on a level playing field and in a system of

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[109] For scepticism towards the effectiveness of coordination of national supervisory authorities and peer reviews see Ferrarini, G and Chiarella L, Common Banking supervision in the Eurozone: Strengths and Weaknesses, ECGI – Law Working Paper No. 223/2013 (2013) p. 35-36 and Levi, L M, 'The European Banking Authority: Legal Framework, Operations and Challenges Ahead' (2013) 28 *Tulane European and Civil Law Forum* 51, 80-82.

[110] For an overview of the rather "extensive" powers of ESMA and potential limits arising from the case law of the European Court of Justice see Tridimas, T, 'Financial Supervision and Agency Power: Reflections on ESMA' in Shuibhne, N and Gormley, L (eds), *From Single Market to Economic Union: Essays in Memory of John A. Usher* (2012) 55, 65-76; for an overview see also Di Noia, C, and Furlò, M, n 93 above, 180-183.

[111] ESA Regs, Art. 17 para. 6

[112] ESA Reg, Art. 18 para. 4.

[113] ESA Reg. 19.

undistorted competition will be furthered by the ESAs because they also have the task to propose binding regulatory (ESA Regs Art. 10) and implementing (ESA Regs, Art. 15) ‘technical standards’, which are subsequently adopted by the Commission, and which, by enhancing the Lamfalussy procedure for adopting delegated ‘level 2’ rules are targeted towards the establishment of a European single rule book.[114]

Overall, management and coordination in the ESFS deploys different types of orchestration mechanism. One might go so far as to describe the interplay between coordination of national supervisors and decision-making in the ESA Board of Supervisors, for example, as a ‘hub-and-spoke system’[115]. The Board of Supervisors has the power to adopt all decisions relating to binding legal instruments, thus implementing the ESAs’ rule-making power.[116] Since it is composed of the head of the national public authorities competent for the supervision of financial market participants (voting member) in addition to representatives of each of the European Commission, the European Risk Board (ESRB, further explained below) and the other two ESAs as non-voting members, interaction between the rule-making hub and the implementing spokes on the national supervisory level is secured.[117] But at the same time, there is no denying the fact that the instances where the

[114] For an overview see Di Noia and Furlò, n 93 above, 178-179. For details on Regulatory Technical Standards (RTS), the related problems of delegation and the involvement of the Commission cf. Levi, n 109 above, 67-73 and Wymeersch, n 93 above, 249-255.

[115] Wymeersch, n 93 above, 235.

[116] ESA Regs, Art. 43 para. 2.

[117] For the composition of the Board of Supervisors see ESA Regs, Art. 40.

ESAs can exercise direct supervisory powers to take individual decisions addressed to financial market participants and to national supervisors reveal elements of hierarchy.[118]

4.2. Macro-prudential supervision by the ESRB

Any classification of the nature of the orchestrating interactions in the ESFS becomes more ambiguous with regard to the ESRB. According to Regulation (EU) No. 1092/2010, Art. 3 para. 1 "the ESRB shall be responsible for the macro-prudential oversight of the financial system within the Community…". A look at the implementation of this responsibility under Regulation (EU) No. 1092/2010, Art. 3 para. 2 makes clear how closely intertwined macro- and micro-prudential oversight now are in the EU. The decision-making body of the ESRB, its General Board, comprises of 61 voting and non-voting members reflecting macro- and micro-prudential interests, the former including the governors of the national central banks, the president and the vice-president of the ECB, a member of the European Commission and the chairpersons of the three ESAs (Regulation (EU) No. 1092/2010, Art. 6 para. 1). But governance difficulties arise. In light of the potential need for effective decision-making in a crisis situation, this high number of voting members, possibly dominated by central bankers, may seem inappropriate for the ESRB's mission.[119] This last factor may make the ESRB appear as a coordination mechanism among central bankers, rather than a self-standing organization on its own, particularly as it has been set up by a regulation under Article 114

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[118] Black, J, 'Restructuring Global and EU Financial Regulation: Character, Capacities, and Learning' in Wymeersch et al n 76 above,) 3, 32.

[119] House of Lords, European Union Committee, 20th Report of Session 2010-2012, The EU Financial Supervisory Framework: an update, HL Paper 181, p. 25; Ferran, E and Alexander, K, Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board' (2010) *ELR* 751 and Directorate General for Internal Policies, Policy Department A: Economic and Scientific Policies, Economic and Monetary Affairs, 'Systemic Risk and the ESRB', Briefing Paper, 2009, p. 6.

TFEU as a body without legal personality or autonomous intervention power.[120] This rather weak status is also adversely affected by its lack of legal enforcement because, without more, the ESRB warnings and recommendations are not legally binding, even though it can bring to bear political pressure on the basis of an "act or explain" mechanism, when Member States or the respective ESA do not adequately justify their non-compliance with ESRB recommendations (Regulation (EU) No. 1092/2010, Art. 17).[121]

4.3. Towards a European Banking Union with the Single Supervisory Mechanism (SSM)

In light of the limits to convergence arising from the competence limitations on the ESAs and the strictly macroprudential focus of the ESRB and its 'soft law' status, the Single Supervisory Mechanism (SSM), which is based on a proposal of the European Commission of 2012 and on a regulation adopted in October 2013[122], centralizes specific macroprudential supervisory tasks by conferring them on the ECB in relation to credit institutions from euro area Member States and non-euro Member States that choose to participate. In this way the participating Member State banking authorities are excluded from exercising their respective supervisory competence. At the same time, however, the designation of the SSM as a 'mechanism' clearly indicates that the newly established framework does not amount to the

[120] For more details on the status of the ESRB see Ferran and Alexander ibid 23-25. For scepticism with regard to the independence of the ESRB, see Kost de Sevres, N and Sasso, L, 'The new European financial markets legal framework: a real improvement? An analysis of financial law and governance in European capital markets from a micro- and macro-economic perspective' (2011) 7 *Capital Markets Law Journal* 30, 46-47.

[121] On the resulting power of the ESRB see Ferran and Alexander, n 119 above, 30-31.

[122] 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 (2013) OJ L287/63.

setting up of a new institution, but confers specific supervisory tasks on the ECB – in compliance with the Treaty, and so relies on the ECB for its organizational design.[123]

At the same time this reliance makes clear that the SSM as opposed to the ESFS aims at the governance of monetary policy, instead of primarily – as has been seen under 4.1 with respect to the ESFS – centering on microprudential supervision and the coordination involved with regard to implementing measures. This focus is explained by the SSM's specific role for the realisation of the European Banking Union. Hand in hand with it goes the leading role for the ECB in the latter's supervisory scheme providing for close interaction between the ECB and local supervisory authorities. Therefore the SSM builds on one of the existing EU entities provided by the EU Treaty instead of establishing a new federal agency. This reliance on the ECB can be traced back to the failure of the banking system with the emerging need for a link between the governance of credit and monetary policy, as they have become particularly apparent throughout the sovereign debt crisis.[124] On the occasion of widespread defaults and resulting business failures the latter has made clear the remaining obstacles to financial stability, and to the functioning of financing mechanisms in the euro zone, and more generally to trust towards a stable future for the European Monetary Union. In addition, during the crisis the loop between banks and sovereign states turned out to be increasingly harmful because it resulted in taxpayer-funded bailouts of financial institutions considered too systemic to fail. These bank rescues in turn inevitably produced moral hazard problems and have significant

[123] According to TFEU, Art. 127 para. 6 and Art. 25 para. 2 of the Statute of the ESCB/ECB (Protocol [No. 4] on the Statute of the European System of Central Banks and of the European Central Bank of 26 October 2012 (2012) OJ C326/230) the jurisdiction of the ESCB can be further extended by a legislative act, conferring specific tasks with respect to prudential supervision on the ECB.

[124] Capriglione, F and Semeraro, G ,Financial crisis and sovereign debt: the European Union between risks and opportunities' (2012) 1, Pt. 1 *Law and Economics Yearly Review* 4, 51-57.

implications for the level playing field of the EU financial market.[125] The avoidance of these problems requires credible backstop mechanisms at the EU level that will do away with the harmful link between banks and sovereigns.[126] That is why a common bank resolution scheme is needed in order to spread the risks and costs of bank failure without national biases.[127]At the same time the single resolution mechanism could open the possibility to recapitalize banks directly in compliance with state aid rules without burdening national taxpayers.[128] Such a fiscal backup is provided by the European Stability Mechanism.[129] In comparison with the latter, the SSM goes further to break the link between banks and sovereigns, putting the organization of supervision into the hands of the ECB as an independent institution, whereas the decision-making body of the ESM, the Board of Governors, consists of the finance ministers of the ESM Member States.[130]

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[125] For examples see Ferrarini and Chiodini, n 95 above, 193, 199-201

[126] Ferrarini, G and Chiarella, L, n 109 above, 62-63.

[127] Beck, T, Gros, D and Schoenmaker, D, 'On the Design of a Single Resolution Mechanism'. In European Parliament, Directorate General for Internal Policies (ed), *Monetary Dialogue,* 18 February 2013, 29, 37-38; for the regulation on the single resolution mechanism (SRM) see European Parliament, *Legislative Resolution of 15 April 2014 on the proposal for a regulation of the European Parliament and the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council,* (COM(2013)0520 – C7-0223/2013 – 2013/0253(COD)) (Ordinary legislative procedure: first reading).

[128] European Commission, *Communication from the Commission to the European Parliament: A Roeadmap towards a Banking Union,* COM (2012) 510 final of September 12, 2012, 3 n. 5.

[129] Wymeersch, E, The single supervisory mechanism or „SSM", part one of the Banking Union (April 1, 2014), National Bank of Belgium Working Paper No. 255, 11.

[130] Underlining the independence of the ECB in the context of the SSM Wymeersch, ibid 25; for the Board of Governors of the ESM see Art. 5 para.2 of the Treaty establishing the European Stability Mechanism (ESM) 2012, available at http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf.

In substance, the ECB will be in charge of supervising approximately 130 larger banks under the criteria specified in Council Regulation (EU) No. 1024/2013, Art. 6 para. 4.[131] Only banks with assets for more than EUR 30 billion or more than 20% of national GDP will be directly supervised by the ECB. In each participating country, at least the three most significant credit institutions will be subject to direct supervision by the ECB, irrespective of their absolute size. Under these criteria, direct supervision of the ECB will extend to banks accounting for approximately 85% of euro area banking assets.[132] According to Council Regulation (EU) No. 1024/2013, Art. 4, for these banks the ECB has exclusive competence for the authorization and withdrawal of authorization of these credit institutions – all banks, not just the big ones (Art 6(4)), to act as competent home state authority in the case of credit institutions that want to establish a branch or provide cross-border services in non-euro area Member States, for assessing applications for the acquisition and disposal of qualified holdings in credit institutions – again, all banks not just the big ones (Art 6(4)), and for ensuring compliance with prudential requirements and supervisory reviews, including stress tests.[133]Despite this seemingly clear-cut division of responsibilities between national authorities and the ECB, the SSM relies on a system of cooperation because, under Council Regulation (EU) No. 1024/2013, Art. 6 para. 6, local supervisors act as ancillaries to the ECB.[134]

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[131] Levi, n 109 above, 97.

[132] Ferrarini and Chiarella, n 109 above, 44.

[133] For an analysis see Ferran, E and Babis, V, 'The European Single Supervisory Mechanism' (2013) 13 *Journal of Corporate Law Studies* 255, 260-266 and Capriglione, F, 'European Banking Union. A Challenge for a more United Europe' (2013) 1 *Law and Economics Yearly Review* 5, 30-32.

[134] For an analysis of the relationship between the ECB and national authorities under the SSM see Ferrarini and Chiarella, n 109 above, 46-49.

Therefore, to a certain degree, the nexus between banks and sovereigns might be considered to be broken under the SSM.[135] But even though the ECB will be able to exercise overall oversight on the basis of the "framework" decision under Council Regulation (EU) No. 1024/2013, Art. 6 para. 7, as set out in the ECB SSM Framework Regulation[136], it does not have any disciplinary power except for the power to impose administrative penalties as specifically provided for under Art. 18, and to preempt national supervisors (Council Regulation (EU) No. 1024/2013, Art. 6 para. 5b).[137] This makes clear that the completion of Banking Union requires further steps to avoid conflicts of interest between national authorities and the SSM, and to ensure optimal burden sharing and the proper functioning of ECB monetary policy implementation. These outcomes are in particular targeted by the recent EU agreements on deposit insurance and crisis management, including resolution, recently reached between the European Parliament and the Member States.[138]

In this context the recent adoption of the Single Resolution Mechanism by the European Parliament is of particular importance.[139] It is a necessary complement to the SSM

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[135] For a classification as a "semi-strong framework" see Ferrarini and Chiarella, n 109 above, 49-61.

[136] Regulation (EU) No. 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation (ECB/2014/17) [2014] OJ 141/1.

[137] Council Regulation (EU) No. 1024/2013, n 122 above, Art. 6 para. 5b

[138] European Commission, 'Commissioner Barnier welcomes agreement between the European Parliament and Member States on Deposit Guarantee Schemes' – MEMO/13/1176 17/12/2013, Brussels, 17 December 2013 and European Commission – MEMO/13/1140 12/12/2013, 'Commissioner Barnier welcomes trilogue agreement on the framework for bank recovery and resolution', Brussels, 12 December 2013.

[139] European Parliament, *Legislative Resolution of 15 April 2014 on the proposal for a regulation of the European Parliament and the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single*

to complete the Banking Union not only because it may prevent moral hazard as laid out above with respect to national bank rescues, but also because it contributes to greater credibility of the SSM, which would be deteriorating if dependent on national resolution authorities' interventions.[140] The SRM is based on the transfer and mutualisation of contributions to the Single Resolution Fund levied from banks which are subject to the supervision by the SSM, so that the link between bank resolution and fiscal ressources, as shown above to be potentially vulnerable to abuse, is broken.[141] Since the supervisory board of the SSM will be able to trigger a resolution, the overlap between these two supervisory mechanisms is obvious, without however leaving national resolution authorities completely aside, which are represented on the Single Resolution Board, the main decision-making body of the SRM.[142] As has been shown above, only on the basis of these interconnected measures, can corrosive expectations of national bail-outs, moral hazard, and excessive risk taking be eliminated.[143]

In light of this closely knit system of macroprudential supervision, the question about its relationship with the European System of Financial Supervision as specifically represented

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Bank Resolution Fund and amending Regulation (EU) No 1093/2010 of the European Parliament and of the Council, (COM(2013)0520 – C7-0223/2013 – 2013/0253(COD)) (Ordinary legislative procedure: first reading).

[140] Véron, N and Wolff, G, Next Steps on the Road to a European Banking Union: the Single Resolution Mechanism in Context, in European Parliament, Directorate General for Internal Policies (ed), *Monetary Dialogue,* 18 February 2013, 5, 19-20.

[141] For the establishment of the SRF see European Parliament, *Legislative Resolution of 15 April 2014 on the SRM,* n 139 above, consideration 11.

[142] Art. 39, European Parliament, *Legislative Resolution of 15 April 2014 on the SRM,* n 139 above.

[143] On the need for ex ante burden-sharing mechanisms see Ferrarini and Chiarella, n 109 above, 58-59.

by the ESRB and the ESAs necessarily arises.[144] This particularly applies with respect to the EBA, given the latter's powers and responsibilities for bank supervision. As noted above, the EBA has standard setting powers, ultimately working towards a single rulebook for the financial sector, and can intervene in case of a breach of EU law by a national competent authority (see 4.1.). What is more, in the event of a crisis its power to intervene goes even further, involving contingency planning and stress tests as well as binding decisions with respect to national authorities.[145] With the start of the SSM the exercise of these powers may be increasingly influenced by the ECB because there will be a non-voting member representing the ECB on the EBA's Board of Supervisors and entitled – as opposed to non-voting members of the Board in general – to attend discussions about individual financial institutions.[146] In light of the very different institutional framework specific to the ECB within the EBU, the widely spread fear that the SSM and the resulting change of the EBA governance could adversely affect the EBA's integrating and coordinating functions and the

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[144] Art 1 para. 3, Regulation (EU) No. 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, [2010] OJ L 331/1.

[145]In more detail see amended EBA Regulation Regulation (EU) No. 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific task on the European Central Bank pursuant to Council Regulation (EU) No. 1024/2013, Art. 22 para.2, 32 para. 2 (d), para. 3a; for further discussion on these powers of the EBA in emergency situations see Ferrarini and Chiodini, n. 95 above, 220-222; Wymeersch, n. 93 above, 263-265.

[146] Regulation (EU) No. 1093/2010 establishing a European Supervisory Authority (European Banking Authority) (2010) OJ L 331/12, Art. 40 para. 1 (d) and the amended EBA Regulation Regulation (EU) No. 1022/2013, Art. 40 para. 4a; on the likely effect of this representation see Wymeersch, n. 129, 69; for more details on the interface between ECB and EBA supervision see Ferran and Babis, n. 133, 276-278.

ensuing political debate about the institutional framework are hardly surprising.[147] With the ECB as the European banking supervisor, the Member States who are not part of the eurozone are not without more included in the SSM, but can join it on the basis of a "close cooperation" regime.[148] As long, however, as non-eurozone Member States do not see a reason for joining the SSM, the danger of disintegration is apparent.[149] Disintegration may still be furthered by changes of the decision-making procedures of the EBA, which aim to accommodate the fears of non-euro Member States mentioned above and which introduce the requirement of a double majority on certain types of decisions, such as those on regulatory matters. According to these changes approval is required by both a majority of Member States participating in the SSM and a majority of non-participating Member States.[150] The spill-over effect of SSM membership and the resulting disproportionate influence of few non-eurozone countries on EBA decision-making, amounting to a blocking position of the UK, which is most likely not to join the SSM in the foreseeable future, are quite clear.[151] Therefore the ultimate goal of a true European Banking Union may be rather ambitious in light of the possible political bargaining over financial supervision and ensuing compromise on financial supervision.[152] In

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[147] House of Lords, European Union Committee, European Banking Union: Key issues and challenges, 7th report of Session 2012-13, 12 December 2012, § 138.

[148] Regulation (EU) No. 1024/2013, Art. 1; see Wymeersch, n. 129 above, 63-64.

[149] Gurlit, n. 71 above, 14.

[150] Verhelst, S, The Single Supervisory Mechanism: A Sound First Step in Europe's Banking Union? Egmont Paper 58, 2013, 34-35.

[151] Verhelst, ibid 35; Wymeersch, n. 129 above, 70; for criticism see Tröger, T, The Single Supervisory Mechanism – Panacea or Quack Banking Regulation? 2013, 30-32.

[152] For the need for a centralised supervision for a banking union Wymeersch, n. 129 above, 6-7; pointing out the threat of political compromise to financial supervision Ferran and Babis, n. 133 above, 255, 282.

the end, the SSM may thus also play a disintegrative role for the internal financial market instead of marking the “first step towards a banking union”.[153]

5. Conclusion

The goal of an internal financial market in the EU has been pursued in different ways according to the different stages of capital market development in the EU. In the beginning, the basic question of how to accommodate cross-border capital flows served as the point of departure for the home country principle and for the ensuing regulatory harmonization strategy. In the second stage, the problem of how to ensure a uniform application of harmonized rules, as a necessary requirement for a truly level playing field, necessarily had to resolved. That was the background against which the Lamfalussy process, as the essential institutional framework for implementing the FSAP, was designed. In a further step, and following the financial crisis, regulation and supervisory oversight has become more concentrated at EU level, under the new European supervisory architecture (the ESFS), in order to achieve regulatory convergence and to centralise cross-border supervision to the extent deemed appropriate. At the same time, throughout the financial crisis a concern for a different kind of coordination has become apparent, namely the coordination of systemic risk management, on the basis of an over-arching macroprudential oversight in the framework of the European Banking Union under the lead of the ECB. The future will tell whether this very ambitious concept is a further step towards the evolution of an integrated market and whether it will satisfy the needs for market integrity and confidence.

[153] With respect to the goal of a banking union see consideration 12, 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 (2013) OJ L287/63; for scepticism see Gurlit, n. 71 above, 14, 15.

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