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Institutional Governance and Capital Markets Union: Incrementalism or a “Big Bang”?

by

NIAMH MOLONEY*

This article considers the institutional governance issues raised by Capital Markets Union (CMU) and suggests that the preferences of administrative actors are likely to have a determinative influence on how institutional governance develops as the CMU project evolves. Specifically, the incentives, powers, and preferences of ESMA (the European Securities and Markets Authority) are likely to have a significant effect on how institutional governance for the EU capital market develops as the CMU project beds in. Member States’ preferences will continue to exert a strong influence but this is most likely to be with respect to whether further centralization of institutional governance for the euro area will occur, as is clear from the February 2016 ‘New Settlement’ between the EU and the UK, agreed by the European Council. The article also considers the likely pace and nature of the future evolution of institutional governance for the EU capital market. It draws on the insights of experimentalist governance theory and on empirical observation of ESMA’s recent activities to suggest that incremental change, rather than a ‘big bang,’ is likely. It remains to be seen whether the CMU agenda injects an accelerating factor into this evolutionary process or, conversely, and by distracting the EU from necessary institutional reforms, disrupts incremental developments.

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Acronyms

BTS	Binding Technical Standard
CCP	Central clearing counterparty
CMU	Capital Markets Union
CRD IV/CRR	2013 Capital Requirements Directive/Regulation
EBA	European Banking Authority
ECB	European Central Bank
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
FSB	Financial Stability Board
MiFID II/ MiFIR	2014 Markets in Financial Instruments Directive/Regulation
RTS	Regulatory Technical Standard
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism

I. Institutional Design and EU Financial System Governance

1. Introduction

Capital Markets Union (CMU) is the EU's current political and policy pre-occupation in the financial governance sphere. While associated in particular with the summer 2014 appointment of Commission President Juncker,¹ its formal launch came with the Commission's Green Paper in February 2015² which was followed by the presentation of the Commission's Action Plan in September 2015.³ CMU has two flagship initiatives: reform of the harmonized prospectus regime (a proposal was presented in November 2015⁴); and the adoption of a harmonized regime for securitizations, including a specific regime for 'simple, transparent, and standardized' securitizations⁵ (political agreement on the securitization proposals was reached by the ECOFIN Council on 8 December 2015). The CMU agenda includes, however, a host of regulatory and non-regulatory initiatives, including, in the short to medium-term, with respect to covered bonds, investment fund reform, private placements, crowd-funding, and the infrastructure supporting the transmission of information on small and medium-sized enterprises (SMEs); and, on a more long-term basis, the potential harmonization of insolvency and taxation regimes. CMU is concerned with the fund-raising capacity of the single EU capital market and, in particular: with the improvement of access to finance by all companies but particularly SMEs; with an increase in and the diversification of sources of funding beyond the currently dominant bank funding channel; and with the achievement of a more efficient and effective EU capital market. The CMU agenda is framed by five priorities: it should provide more funding choices for Europe's businesses and SMEs; ensure an appropriate regulatory environment

- 1 CMU forms part of the Juncker Commission agenda: 'A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Democratic Change. Political Guidelines for the next European Commission', 22 October 2014.
- 2 Commission (EC), 'Building a Capital Markets Union' (Green Paper) COM (2015) 63, 18 February 2015.
- 3 Commission (EC), 'Action Plan on Building a Capital Markets Union' COM (2015) 468, 30 September 2015.
- 4 Commission (EC), 'Proposal for a Regulation of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading' COM (2015) 583, 30 November 2015.
- 5 Commission (EC), 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms' COM (2015) 473, 30 September 2015; and Commission (EC), 'Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitization and creating a European framework for simple, transparent and standardised securitisation' COM (2015) 472, 30 September 2015. Related reforms have been made to the Solvency II regime (C(2015) 6588/2).

for the long-term and sustainable investment and financing of Europe's infrastructure; increase investment choices for retail and institutional investors; enhance the capacity of banks to lend; and bring down cross-border barriers and develop capital markets for all 28 Member States.⁶

CMU, despite its currency and notwithstanding the attention it is receiving politically (including in connection with the European Council's February 2016 'New Settlement' for the UK within the EU which, *inter alia*, addresses the interaction between euro area and non-euro-area financial governance and which has implications for the CMU project⁷), from the market, and from the EU institutions,⁸ presents a dilemma. Does it mark a significant moment for EU financial governance (which can be regarded as the matrix of rules, supervisory practices, enforcement mechanisms, resolution/recovery devices, and the supporting institutional infrastructure which governs the EU financial system) and related scholarship? Or is it simply another example – one among the many – of incrementalism in EU financial governance? Is there a danger of mistaking the spectacular but potentially transient political pyrotechnics associated with the CMU project for real innovation in EU financial governance? Might the CMU agenda distract from, for example, functional weaknesses, legal ambiguities, or constitutional tensions in EU financial governance more generally and which are of wider significance? Ultimately, does CMU provide a productive case study which can be used to critique EU financial governance?

This article suggests that the institutional governance issues raised by the CMU agenda, and in particular the implications for the European System of Financial Supervision (ESFS), are worthy of examination.⁹ The institutional governance structures of the ESFS have only recently emerged from their crisis-era crucible. They are still in an experimental phase: constitutional, functional, institutional, and political tensions and pressures remain considerable. A cognate literature

6 Action Plan (n 3) 4–6. A status report on progress was issued by the European Commission in April 2016 (SWD (2016) 147).

7 Decision of the Heads of State or Government Meeting Within the European Council, 'Concerning a New Settlement for the United Kingdom with the European Union,' European Council Meeting, 18 and 19 February 2016 (EUCO 1/16), Annex 1. The relevant principles are set out in Annex 1, Section A, Economic Governance. The Decision takes effect only if the UK decides to remain a member of the EU.

8 The European Parliament (Resolution on 'Building a Capital Markets Union' B8-0655/2015, 1 July 2015), ECB ('Building a Capital Markets Union – Eurosystem Contribution to the European Commission's Green Paper', 2015), and European Council ('Resolution of 10 November 2015' Press Release 791/15) are broadly supportive.

9 For a consideration of the further implications of the CMU project see eg N Moloney, 'Capital Markets Union: "Ever Closer Union" for the EU Financial System?' (2016) ELRev, forthcoming and the discussions in the 2015 (3) Special Edition of the Law and Financial Markets Review.

is fast developing which seeks to conceptualize the related nascent administrative law and to understand the forces shaping the new institutional structures.¹⁰ This article seeks to contribute to this emerging scholarship by speculating on how institutional governance for the EU capital market is likely to evolve in the context of CMU. To do so, it draws on empirical observation – particularly of the European Securities and Markets Authority (ESMA) which operates within the ESFS – and on related scholarship. It suggests that the predictions of the relevant political economy literature as to the determinative influence of Member States’ preferences but also, increasingly, of the preferences of administrative actors – chief among them financial regulators – on the evolution of institutional governance are likely to be borne out over the CMU reform period. While Member States’ preferences are likely to exert a strong influence on the evolution of institutional design for the EU capital market, this is most likely to be with respect to any further centralization of institutional governance for the euro area, as is clear from the February 2016 ‘New Settlement’ for the UK.¹¹ ESMA, however, is likely to emerge as the primary operational influence on how institutional governance develops for the EU/single capital market as a whole as the CMU agenda beds in.

The article also considers a related question as to the likely pace and nature of the evolution of institutional governance for the EU capital market. It suggests that ESMA-led change is likely to be incremental. A dynamic, fluid, and responsive process will likely develop through which national financial regulators and ESMA will converge towards a more European approach to capital market governance. It remains to be seen whether the CMU agenda will inject an accelerating factor into this evolutionary process or, conversely, and by distracting the EU from necessary institutional reforms, disrupt the current evolutionary trajectory.

Section I considers the interaction between the CMU reform agenda and institutional governance and situates the analysis within relevant scholarship. Section II outlines the current institutional structure. Section III considers how the institutional question should be framed – as a ‘Capital Markets Union’ question, or as a question for a more elusive ‘Financial Union’? Section IV considers the institutional governance implications with respect to regulatory governance. Section V considers the implications with respect to supervisory governance. Section VI concludes.

10 For recent examples see, eg: E Ferran, ‘The Existential Search of the European Banking Authority’ (2015) ECGI Law Working Paper No. 297/2015 <<http://ssrn.com/abstract=2634904>>; and M Busuioc, ‘Rule-making by the European Financial Supervisory Authorities: Walking a Tight Rope’ (2013) 19 *ELJ* 111.

11 N 7.

2. *CMU and Institutional Governance: A Question Worth Asking*

Does the CMU agenda present a useful case study for the assessment of EU financial governance? In many respects, there is nothing new about the CMU project.¹² CMU is a – broadly – regulatory agenda; it is designed to support market-based finance; and it is directed to the construction of a single market in capital. All of these features have long been associated with EU financial market law and policy. They can be found as far back as 1966, in the seminal Segré Report on a European capital market.¹³ More recently, the 1999 Financial Services Action Plan (FSAP), which laid the foundations of EU financial market law as currently constituted, had all these features.¹⁴ Even over the crisis-era, during which the EU policy and political community was primarily concerned with financial stability, reforms were adopted which deployed harmonized regulation to support the embedding of market finance and of cross-border capital-raising. These include: the ‘SME Growth Market’ reform adopted under the 2014 Markets in Financial Instruments Directive to ease market access by SMEs;¹⁵ the calibrations to the 2012 European Market Infrastructure Regulation (EMIR) designed to protect non-financial counterparties from excessive regulatory costs when engaging in hedging through derivatives;¹⁶ and the series of fund-structure-related reforms designed to support capital accumulation and allocation, including the 2013 European Venture Capital Regulation and the 2015 European Long Term Investment Fund Regulation.¹⁷

It is also the case that CMU might prove something of a distraction. The massive crisis-era reform process closed with the completion of the 2010–2014 Parliamentary term in April 2014 and the adoption of the last major suite of crisis-era measures. The legal architecture for Banking Union is now, for the most part, in

12 See further Moloney (n 9).

13 ‘Report by a Group of Experts Appointed by the EEC Commission, The Development of a European Capital Market’, 1966.

14 Commission (EC), ‘Communication on Implementing the Framework for Financial Markets. Action Plan’ COM (1999) 232, 11 May 1999 (FSAP).

15 Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L173/349 (MiFID II), art 33. MiFID II is accompanied by Regulation (EU) No. 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No. 648/2012 [2014] OJ L173/84 (MiFIR).

16 Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties, and trade repositories [2012] OJ L201/1 (European Market Infrastructure Regulation (EMIR)).

17 Regulation (EU) No. 345/2013 of the European Parliament and of the Council on European Venture Capital Funds [2013] OJ L115/1 and Regulation (EU) No. 760/2015 of the European Parliament and of the Council on European Long-term Investment Funds [2015] OJ L123/98.

place. The Single Resolution Mechanism (SRM) is established and the Single Supervisory Mechanism (SSM) is now operational and in a ‘business as usual’ phase. With respect to the SSM, the ECB has, for example, concluded its initial series of ‘SREP’ (Supervisory Review and Evaluation Process) supervisory exercises – which are required under CRD IV/CRR¹⁸ of all EU bank supervisors – over the banks within its direct supervision,¹⁹ and has set out its supervisory priorities for 2016.²⁰ With respect to regulatory governance, the EU’s institutional apparatus is now turning to review of the crisis-era reforms. Summer/Autumn 2015 saw the Commission launch major consultations on the market impact of the CRD IV/CRR reforms²¹ and on the impact of EU financial regulation more generally,²² while the European Parliament has examined how the EU should review the recent reforms and position the financial governance agenda for the future.²³ The review clauses contained in the crisis-era measures are beginning to activate²⁴ while empirical evidence on the impact of the EU’s crisis-era reform programme is slowly emerging.²⁵ The time for review and assessment has arrived.

But this review and assessment must include institutional governance, particularly given the richness of the empirical observation now possible of the ESFS and of the ESAs since their 2011 foundation. The performance of the ESFS and the ESAs was subject to formal review by the Commission in 2014²⁶

18 Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012 [2013] OJ L176/1; and Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L176/338.

19 ECB, ‘Annual Report on Supervisory Activities 2014’ (2015) and ‘Annual Report on Supervisory Activities 2015’ (2016).

20 ECB, Banking Supervision, Press Release 6 January 2016.

21 Commission (EC), ‘Possible Impact of the CRR and CRD IV on Bank Financing of the Economy’, 15 July 2015.

22 Commission (EC), ‘Call for Evidence: EU Regulatory Framework for Financial Services’, 30 September 2015.

23 European Parliament, ‘Resolution on Stocktaking and Challenges of the EU Financial Services Regulation: impact and the way forward towards a more efficient and effective EU framework for financial regulation and a Capital Markets Union’, 19 January 2016 (P8_TA-PROV2016(0006)) (Balz Resolution).

24 EMIR, eg, is currently being reviewed: Commission (EC), ‘Public Consultation on EMIR’, 21 May 2015.

25 Eg, EBA, ‘Overview of the potential implications of regulatory measures for banks’ business models’, 9 February 2015.

26 Commission (EC), ‘Report from the Commission to the European Parliament and Council on the operation of the ESAs and the ESFS’ COM (2014) 509, 8 August 2014.

and a related reform agenda is expected (by mid 2016). The CMU project provides, however, a useful launch-pad from which to examine further the likely future evolution of institutional governance for the EU capital market. Review is all the more necessary given the increasingly problematic inter-connection between CMU governance and euro area governance and the as yet untested impact of the February 2016 'New Settlement' between the EU and the UK.

3. *Institutional Design and EU Financial Governance*

Where, accordingly, to situate this discussion of CMU and of related institutional governance for the EU capital market, and how to identify the major points of contestation?

Since its inception, EU financial governance has primarily been a function of inter-institutional rule-making. Legal scholarship on EU regulatory governance has long been pre-occupied with related questions including, for example, the identification of the optimal balance between harmonization and regulatory competition and between EU and Member State intervention.²⁷ In sharp contrast with financial governance at domestic/Member State levels, where, and reflecting the growth of the modern administrative state, technocratic agencies have been conferred with discrete rule-making, supervisory, and enforcement powers to achieve statutory objectives with respect to financial governance,²⁸ the EU has been slow to engage with related institution-building. EU financial governance has typically operated within the EU's wider institutional arrangements and, specifically, within the arrangements governing the adoption of legislation by the co-legislators and of administrative technical rules by the Commission. This feature of EU financial governance reflects in part the location of supervision and enforcement at national level and the related absence, until recently, of pressure for institutional reforms given the long preoccupation of EU financial governance with market liberalization through regulatory governance.²⁹

27 See, eg, L Enriques and M Gatti, 'Is there a Uniform EU Securities Law After the Financial Services Action Plan?' (2008) 14 *Stanford Journal of Law, Business and Finance* 43.

28 For a US perspective see E Barkow, 'Insulating Agencies: Avoiding Capture Through Institutional Design' (2010) 89 *Texas Law Review* 15 and, relating national administrative developments to the slow evolution of administrative structures at the global level, M Barr, 'Who's in Charge of Global Finance' (2014) 4 *Georgetown Journal of International Law* 971.

29 See, eg, from a political economy perspective, L Quaglia, *Governing Financial Services in the European Union. Banking, Securities, and Post-trading* (Routledge, Oxford

But although institution-building has been a latecomer to EU financial governance, its progress has been shaped by deeply rooted political and market forces and by powerful and longstanding constitutional constraints. Institutional design decisions, when they arise, typically expose the deep-set constitutional, institutional, and political fault-lines which rumble underneath the EU financial system. When exposed to stress during the institution-building process, these fault-lines have been shown to have a determinative influence on institutional design, and on the related balance of competence between the EU and its Member States. These fault-lines can be hidden during the regulatory process, given the multiple opportunities for ambiguity, compromise, escape, and obfuscation which this process generates. By contrast, institution-building, given the legacy risks which it generates and the relatively clear ‘bright-line’ decisions it requires as to the allocation of EU and Member State competence, exposes legal/Treaty stresses and political/institutional tensions which might otherwise lie dormant. Institution-building can also be associated with re-settings of the balance of power between the EU and the Member States, and between the EU institutions, with respect to financial governance, given the centralizing effects associated with the institutions of EU financial governance.³⁰

Thus, and to take the example of determinative institutional tensions (and of related Treaty constraints), in the early days of modern EU financial market regulation, over the late 1980s and early 1990s, the EU struggled to adopt an institutional solution to the problems raised by the absence of a nimble, administrative rule-making process for financial governance, given the difficulties generated by Council control over the ‘comitology’ process for administrative rule-making.³¹ The subsequent ‘Lamfalussy’ committees, established to support Commission financial administrative rule-making and a defining feature of the pre-crisis and liberalizing era (1999–2008), were broadly supported, politically, by the Member States. But their construction exposed the extent of the wider institutional and constitutional difficulties posed by the EU’s struggle at the time to achieve a compromise between the Parliament and the Council in relation to oversight of administrative rule-making generally. And, to take another example, while the Lisbon Treaty

2010), and, from a legal perspective, Moloney, N, *EU Securities and Financial Markets Regulation* (3 edn OUP, Oxford 2014) and E Ferran, *Building an EU Securities Market* (CUP, Cambridge 2004).

30 With respect to banking governance and the effects of Banking Union see E Ferran, ‘European Banking Union: Imperfect, But It Can Work’ in D Busch and G Ferrarini (eds), *European Banking Union* (OUP, Oxford 2015) 56.

31 Examples include the failure to establish a ‘Securities Committee’ which would have supported Commission rule-making under the 1993 Investment Services Directive (Council Directive 93/22/EEC on investment services in the securities field OJ [1993] L141/27).

reforms to the administrative rule-making process facilitated the construction of the ESAs in 2011, the decisive influence on their quasi-rule-making functions has been the *Meroni* ruling,³² which limits the extent to which agencies can exercise discretion and so prohibits rule-making by EU agencies such as the ESAs but which has led to some tensions between the Commission, Parliament, and the ESAs with respect to the development of administrative rules.³³

Institution-building has also exposed major political tensions between the Member States, in particular with respect to the extent to which risks should be mutualized and managed at EU level. The ‘fiscal redline’ drawn by certain Member States was among the factors which led to the ESAs being prevented from taking discretionary supervisory decisions which potentially carry fiscal costs for the Member States.³⁴ Although Banking Union is, by contrast, designed to mutualize risk and fiscal costs, the manner and speed of risk mutualization within Banking Union’s Single Resolution Mechanism (SRM) proved a major obstacle to agreement on the SRM.³⁵ Increasingly, political tensions arising from EU financial governance are a product of the relationship between euro area/Banking Union governance and that of the non-euro-area, and of the risk that Banking Union/euro-area caucusing could over-ride the interests of non-euro-area Member States with respect to the governance of the wider single market. The 18–19 February 2016 New Settlement for the UK within the EU³⁶ represents an attempt to ameliorate these tensions and to clarify the relationship between both spheres of financial governance.

The New Settlement is designed to address the UK’s concern, fuelled by Banking Union and the increasing influence of the ECB,³⁷ that euro-area caucusing could lead to euro-area dominance of single market decision-mak-

32 Case 9/56 *Meroni v. High Authority* [1957–1958] ECR 133.

33 See further Moloney (n 29) ch X. A limited number of discretionary supervisory powers are conferred on ESMA, but these powers are typically tightly confined.

34 See further Moloney (n 29) ch XI and A Spendzharova, ‘Is More ‘Brussels’ the Solution? New European Union Member States’ Preferences about the European Financial Architecture’ (2012) 50 *JCMS* 315.

35 For discussion see: K Alexander, ‘A Legal and Institutional Analysis of the Single Supervisory Mechanism and the Single Resolution Mechanism’ (2015) 40 *ELRev* 154; Ferran (n 30); N Moloney, ‘European Banking Union: Assessing its Risks and Resilience’ (2014) 51(6) *CMLRev* 1609; and B Wolfers and T Vorland, ‘Level the Playing Field: the New Supervision of Credit Institutions by the European Central Bank’ (2014) 51(5) *CMLRev* 1463.

36 N 7.

37 Notably following the ECB’s adoption of a location policy for central clearing counterparties (CCPs) which required such CCPs to be located in the euro area. The policy was successfully challenged by the UK before the General Court of the EU: Case T-496/11 *UK v European Central Bank*, 4 May 2015.

ing on financial governance. The New Settlement is also, however, designed to reflect the concerns of euro-area Member States, and particularly France, that the UK not be empowered to veto EU financial governance measures or be given special treatment for its financial institutions.³⁸ The New Settlement contains a set of principles which are designed to affirm that while the euro area can engage in deeper integration to complete EMU, the co-existence of the euro area and of the single market must be acknowledged and protected. Among the principles adopted are affirmations that: the harmonized single rule-book which governs the EU financial system may, within Banking Union, ‘need to be conceived in a more uniform manner’ and that a degree of implementation discretion outside Banking Union is accordingly permitted; and that the implementation by non-euro-area Member States of measures for the purpose of preserving financial stability, and including measures relating to the supervision and resolution of financial institutions and markets, is a ‘matter for their own authorities and own budgetary responsibilities.’³⁹ Accordingly, single-market-wide centralization of supervisory governance and related institution-building can, politically at least,⁴⁰ be resisted by the UK on financial stability grounds.

Further strains follow from the pressure which institution-building places on the Treaties. Article 114 TFEU – the competence workhorse of EU financial governance – has proved to be something of a rickety basis for the ESFS/ESA reforms and for the SRM within Banking Union.⁴¹ The Court of Justice of the EU in the 2014 *Short Selling* ruling declined to follow the argument of the Advocate General that Article 114 did not support the construction of an ‘EU level decision-making mechanism’ and that certain of ESMA’s direct supervisory powers were accordingly invalid.⁴² But the resilience of Article 114 as a basis for institution-building remains in doubt, and a full challenge to Article 114 as the foundation for the ESAs has yet to be made and may follow, if tensions as to the nature of institutional governance persist. The ESAs and the SRM have also struggled with the constraints which the *Meroni* ruling on the Treaty balance of institutional power imposes on their ability to take

38 As was well-documented during the New Settlement negotiations: eg, A Barker and G Parker, ‘Cameron ‘in good place’ for Brussels deal’, *Financial Times*, 18 February 2016.

39 N 7, Annex 1, Section A, Economic Governance, paras 2 and 4.

40 The legal status of the New Settlement remains contested. It is designed to be ‘an instrument for the interpretation of the Treaties’ but whether it is binding on the EU’s courts is not clear.

41 See, eg, M Scholten and M Van Rijsbergen, ‘The ESMA Short Selling Case. Erecting a New Delegation Doctrine for the EU upon the Meroni-Romano Remnants’ (2014) 41 LIEI 289 and M Chamon, ‘The Empowerment of Agencies under the Meroni Doctrine and Art. 114 TFEU: Comment on the UK v Parliament and Council (Short Selling) and the Proposed Single Resolution Mechanism’ (2014) 39 ELRev 380.

42 Case C-270/12 *UK v Council and Parliament*, 22 January 2014.

discretionary decisions. Elsewhere, the Treaty pre-eminence of the ECB Governing Council (euro area members) has led to design difficulties with the SSM, given that the SSM (and Banking Union) is open to non-euro-area Member States.⁴³

Legal and cognate scholarship has sought to identify and understand these complex institutional, political, and constitutional forces and constraints and how they shape institutional governance for the EU financial system. Legal inquiry has addressed, for example, how the ESAs, as administrative actors, achieve outcomes through the legal tools at their disposal, and has considered their place within and the constraints imposed on them by the EU's constitutional order.⁴⁴ Institutional governance questions have also long been a major concern for the political economy and political science scholars who have charted the forces which have shaped the single financial system and its underpinning governance structures.⁴⁵ As the EU's institutional structures for financial governance have developed, close attention has focused on the interplay between the different intergovernmental forces which have long shaped EU financial governance – and which are shaped in turn by the powerful influences exerted by different underpinning institutional economic models⁴⁶ – and on the nascent forces exerted by the preferences of the new administrative actors of financial governance.⁴⁷ More recently, and over the crisis era, the important notion of the EU's 'regulatory capacity'⁴⁸ as an influence on

43 Ferran (n30).

44 See, eg, Moloney (n29) 854–1009, Busuioc (n10), and P Schammo, 'The European Securities and Markets Authority: Lifting the Veil on the Allocation of Powers' (2011) 48(6) CMLRev 1879.

45 For reviews see D Mügge, 'The Political Economy of Europeanized Financial Regulation' (2013) 20(3) *Journal of European Public Policy* 458 and L Quaglia, 'The 'Old' and 'New' Politics of Financial Services Regulation in the EU' (2012) 17(4) *New Political Economy* 515.

46 For the seminal account (classifying national economies as broadly bank-based (Coordinated Market Economies) or market-based (Liberal Market Economies)) see P Hall and D Soskice (eds), *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage* (OUP, Oxford 2001). For more recent considerations which reflect how banking and market financing structures are increasingly becoming intertwined and blurring the bank/market classification see, eg: I Hardie, and D Howarth, (eds), *Market-based Banking and the International Financial Crisis* (OUP, Oxford 2013).

47 See, eg, E Posner, 'Making Rules for Global Finance: Transatlantic Regulatory Cooperation at the Turn of the Millennium' (2009) 63(4) *International Organization* 665 and D Coen and M Thatcher, 'Network Governance and Multilevel Delegation: European Networks of Regulatory Agencies' (2008) 28 *Journal of Public Policy* 49.

48 In the political economy literature, 'regulatory capacity' is typically associated with the ability of a state to formulate, monitor, and enforce rules: D Bach and A Newman, 'The European Regulatory State and Global Public Policy: Micro-institutions, Macro-influence' (2007) 14(6) *Journal of European Public Policy* 827.

how institutional governance has developed has come to the fore. This concept has proved to have considerable explanatory power as the influence of administrative agencies, key drivers of regulatory capacity, on the design of institutional governance (whether at domestic, regional, or international levels) has become clearer.⁴⁹

Legal analysis accordingly exposes the rules-based constraints which shape how institutional governance develops, and political economy explains and offers predictions as to the type of actor whose preferences shape institutional governance. Regulatory governance theory can shed additional light on the process through and speed at which institutional governance reforms emerge and, in particular, on the nature of incrementalism, dynamism, and momentum in this area.⁵⁰ The ‘experimentalist governance’ strand of EU governance theory has proved to be particularly useful in explaining and predicting how administrative agencies in the EU develop. Experimentalist governance⁵¹ identifies as experimentalist those governance arrangements which supplement (or displace) the traditional ‘command and control’ model of EU governance which has long been based on binding legal rules set through the institutional/political process. Experimentalist governance, by contrast, is based on the setting of general framework goals (by, for example, the EU’s co-legislators, the Parliament and Council, through legislative rules) and, in addition, on the related deployment – at lower levels of governance (such as the ESAs) and with a degree of flexibility and discretion – of different forms of implementing rules, of monitoring devices (including peer review), and of mechanisms for revising goals and rules.⁵² Experimentalist governance predicts that administrative agencies, such as the ESAs, can – outside the political process – deploy the legal and other tools at their disposal to drive governance change, but in a fluid, iterative, and experimental manner which is responsive to changes in their operating environments. Experimentalist governance has proved to be a powerful tool for explaining

49 Eg, T Büthe and W Mattli, *The New Global Rulers: The Privatization of Regulation in the World Economy* (Princeton University Press, Princeton 2011) and E Tsingou, ‘Regulatory Reaction to the Global Credit Crisis: Analyzing a Policy Community under Stress’ in E Helleiner, S Pagliari, and H Zimmerman, (eds), *Global Finance in Crisis. The Politics of International Regulatory Change* (Routledge, Oxford 2010) 21.

50 For a recent account of the dominant theoretical perspectives on EU agency governance see M Egeberg, J Trondal, and N Vestlund, ‘The Quest for Order: Unravelling the Relationship Between the European Commission and European Agencies’ (2015) 22(5) *Journal of European Public Policy* 609.

51 See J Zeitlin (ed), *Extending Experimentalist Governance? The EU and Transnational Regulation* (OUP, Oxford 2015) and C Sabel and J Zeitlin (eds), *Experimentalist Governance in the European Union. Towards a New Architecture* (OUP, Oxford 2010).

52 As identified by Sabel and Zeitlin: ‘Learning from Difference: the New Architecture of Experimentalist Governance in the EU’, in *ibid*, 1, 2–3.

how the ESAs can shape regulatory and supervisory governance and, thereby, incrementally change institutional governance.⁵³

Drawing on these insights, this article suggests that ESMA – the key administrative actor in EU capital market governance – is likely to be the primary influence on how institutional governance for the single capital market develops over the CMU agenda period. Member State interests will determine whether a major re-setting change in the form of the construction of centralized institutional structures for a euro-area-located ‘Financial Union’ will occur, but a ‘big bang’ change of this order is unlikely. ESMA-shaped changes to institutional governance are likely to be incremental and experimentalist in nature but to have potentially significant centralization effects over time. Whether or not, from a functional perspective, the institutional governance solution which emerges will be optimal is not, for the moment, clear.

II. Institutional Governance and the EU Capital Market

1. The ESFS and the EU Capital Market

The institutional governance structure which supports the EU capital market is currently situated within the European System of Financial Supervision (ESFS), established in 2011, which is composed of: the Member States’ national competent authorities (NCAs), which provide the foundations of the system; the three sectoral European Supervisory Authorities (ESAs), which are charged with a range of quasi-regulatory and supervisory/supervisory co-ordination functions – the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and their co-ordinating Joint Committee; and the European Systemic Risk Board (ESRB), which is charged with monitoring pan-EU system-wide risks and macro-prudential stability. Of the three ESAs, ESMA has primary competence with respect to capital markets, although on a range of matters (including, for example, packaged investment products which cross regulatory sectors and shadow banking) it coordinates with its sister EBA and EIOPA authorities.

53 For an experimentalist analysis of EU financial governance from the perspective of EBA see Ferran (n 10) and, for a pre-crisis view, see E Posner, ‘The Lamfalussy Process: Polyarchic Origins of Networked Financial Rule-making in the EU’ in Sabel and Zeitlin (n 51) 43. From the perspective of international governance and the EU’s engagement, see M Campbell-Verduyn and T Porter, ‘Experimentalism in European Union and Global Financial Governance: interactions, contrasts, and implications’ (2014) 21(3) *Journal of European Public Policy* 408.

The ESAs take the form of independent EU agencies, funded – for the moment at least – by a combination of EU and Member State funds. Decision-making is the prerogative of their respective Boards of Supervisors, which are largely intergovernmental in nature, being primarily composed of the relevant NCAs who alone exercise voting power. The ESAs' powers are delegated or conferred and are tightly enumerated, reflecting the constraints which apply to agencies under the EU's constitutional arrangements. With respect to regulatory governance, while legislative ('level 1') rule-making for the EU financial system is the prerogative of the European Parliament and Council and, with respect to administrative ('level 2') rule-making, the Commission, the ESAs propose certain forms of administrative rule ('Binding Technical Standards') to be adopted by the Commission, and also provide the Commission with 'Technical Advice' on administrative rule-making generally. The ESAs can in addition adopt an array of soft law, notably 'Guidelines' in relation to which NCAs can be required to 'comply or explain.'⁵⁴

Supervisory governance remains at Member State level with NCAs. But the ESAs have been conferred with: a range of supervisory co-ordination and convergence powers, including data collection and peer review powers, the power to review certain national supervisory decisions, and powers in relation to participation in colleges of supervisors; a limited range of powers to direct NCAs in specified circumstances (breach of EU law; emergency conditions; and in binding mediation situations); and, in the case of ESMA, specified direct powers of supervision over an ill-assorted group of capital market participants and activities.⁵⁵ These latter and more interventionist and hierarchically superior powers have been conferred incrementally, without overall coherence, and following difficult political negotiations, and apply with respect to credit rating agencies (exclusive ESMA supervision); OTC derivatives market trade repositories (exclusive ESMA supervision); short selling (specified ESMA intervention powers); the prohibition of investment products (specified ESMA intervention powers); and the oversight of positions in commodity derivative markets (specified ESMA intervention powers).

Accordingly, within the ESFS, the institutional governance of the EU capital market is currently shared between the NCAs and ESMA is the primary EU-level actor. The ESRB, however, provides a horizon-scanning role⁵⁶ and sup-

54 Eg, Regulation (EU) No.1095/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Securities and Markets Authority) [2010] OJ L331/84, art16.

55 Under MiFID II/MiFIR EBA will additionally have intervention powers over structured deposits.

56 Eg, ESRB, 'Assessing Contagion Risk from the CDS Market' Occasional Paper No. 4, 4 September 2013.

ports ESMA's quasi-rule-making activities,⁵⁷ while the cross-sector nature of many capital market activities requires coordination between ESMA and EBA/EIOPA through the ESA Joint Committee.

The current institutional governance structure for the EU capital market sits, for the most part, outside the Banking Union structures (the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM)). Only deposit-taking entities come within the SSM. Investment firms are expressly excluded from the scope of the SSM,⁵⁸ as is conduct supervision⁵⁹ – the mainstay of capital markets supervision. There are, however, 'grey zones' in relation to SSM supervision where prudential/banking supervision and conduct/capital market supervision competences may collide.

These include the treatment of conduct risk, which is primarily a concern for capital markets supervisors, but which can also, depending on its nature, generate prudential risks to the stability of a bank.⁶⁰ The SSM is empowered only with respect to the risks associated with prudential supervision (2013 ECB/SSM Regulation, Article 1) – as it must be given the nature of the Treaty competence (Article 126(7) TFEU) which supports the SSM and which covers prudential matters only. The need for careful co-ordination between the EU's capital market institutional governance structures and Banking Union's SSM is considerable, however, as the borderline between traditional conduct supervision (located with NCAs/ESMA) and prudential supervision (located with the ECB/SSM/EBA) is not always clearly marked with respect to the supervisory treatment of different classes of conduct risk.⁶¹ In the investment services field, for example, the 2004 MiFID I⁶² generated confusion as to when particular supervisory activities came within the 'conduct' field and so within

57 It was closely engaged with the development of level 2 rules under EMIR, eg, which requires that ESMA consult the ESRB in particular cases.

58 The SSM applies only to euro area 'credit institutions' as defined under the 2013 CRR (in effect, deposit-taking institutions) and investment firms are expressly excluded: Council Regulation (EU) No. 1024/2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63 (2013 ECB/SSM Regulation, arts 1 and 2(3)). Recital 28, eg, notes that national authorities remain responsible for supervisory actions in relation to markets in financial instruments.

59 Eg, 2013 ECB/SSM Regulation, art 4(1).

60 Conduct risk is increasingly a concern for prudential supervisors. See recently ESRB, 'Report on Misconduct Risks in the Banking Sector' 5 June 2015.

61 In the UK, eg, co-operation between the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) is governed by a detailed and complex set of legislative and operational requirements, although the PRA ultimately can deploy a veto power over FCA activities in particular circumstances.

62 Directive 2004/39/EC of the European Parliament and the Council on markets in financial instruments [2004] OJ L145/1.

the competence of the investment firm branch host NCA (under MiFID I Article 32(7)). The need for co-ordination is acknowledged in Article 3(1) of the 2013 ECB/SSM Regulation which provides for the ECB to enter into Memoranda of Understanding with NCAs ‘responsible for markets in financial instruments’.⁶³ The extent of the potential for coordination difficulties is likely to emerge soon. Under an important set of recent EBA Guidelines on bank supervision, conduct risk is to be assessed (prudentially) by EU banking supervisors, including SSM banking supervisors (which include the ECB which has oversight of the SSM and is directly responsible for the supervision of some 130 banking groups), under the Supervisory Review and Evaluation Process (SREP) required under the EU banking rule-book (CRD IV/CRR).⁶⁴

Other indicators of potential coordination difficulties can be identified. The ECB, acting in a non-SSM capacity, has recently shown some concern, in its policy and research activities, to adopt a wide approach to the definition of shadow banks and to draw in asset managers, although asset managers have traditionally been the concern of and supervised by capital market supervisors.⁶⁵ While ECB reporting and policy measures of this nature cannot override the Treaty restrictions on the specific prudential supervisory powers which the ECB within the SSM can exercise, the possibilities for institutional clashes within the ESFS with respect to softer policy measures relating to the capital markets cannot be dismissed.

Accordingly, and as discussed in section V, ESMA/ECB dynamics are also likely to play a part in determining how the current institutional settlement for the EU capital market develops.

2. ESMA, the EU Capital Market, and the CMU Agenda

ESMA, in the five years since its 2011 foundation, has established itself as a technocratic authority with considerable market, institutional, and political credibility, as evidenced by a series of positive reviews from, for example, the Commission, the Parliament, and the IMF.⁶⁶ Its regulatory and supervisory governance activities are considered further in sections IV and V.

63 Similarly, recital 33 to the 2013 ECB/SSM Regulation calls for MoUs between the ECB and NCAs for markets in financial instruments which describe how these actors will cooperate in their performance of supervisory tasks.

64 EBA, ‘Guidelines on Common Procedures and Methodologies for the Supervisory Review and Evaluation Process’ EBA/GL/2014/13 (2014), paras 253–257, requiring SREP supervisory review of conduct risk, including with respect to mis-selling and conflict of interest failures.

65 ECB, ‘Report on Financial Structures’ 29 October 2015.

66 Commission (n 26); European Parliament, ‘Resolution on the European System of Fi-

Institutionally, ESMA's relations with the co-legislators and the Commission appear, broadly, stable (although, as outlined later in this discussion, there are some indications of growing tensions in its relations with the Commission and European Parliament), and there appears to be little institutional appetite for material changes to ESMA's powers. The Commission did not, following the 2013-2014 ESFS Review, propose major changes to the ESAs/ESMA, confining its reform agenda to a range of more or less technical issues, including: governance reforms (including the conferral of voting power on the ESA Chairpersons); clarification of the ESA binding mediation power (discussed in section V below); and, most controversially, a move to an industry-based funding model.⁶⁷ It is unlikely that radical proposals for change will follow in the related reform proposals, expected in mid 2016. There are also few indications of an institutional or political appetite to use the CMU agenda to change the current ESMA-based settlement for EU capital market institutional governance. The Commission's September 2016 Action Plan touches only tentatively on institutional governance matters, calling only for ESMA's supervisory convergence activities to be strengthened.⁶⁸ The European Parliament, as discussed in section V, appears increasingly sensitive to accretions of power by the ESAs, further reducing the likelihood of institutionally-driven change. Politically, the European Council has endorsed the Commission's minimalist approach, 'emphasizing' in its November 2015 Resolution on CMU the Commission's conclusion that the CMU agenda can be taken forward within the existing mandates of the ESAs, although also calling for a strengthening of supervisory convergence.⁶⁹

But it is unlikely that the CMU agenda will not have any implications for the institutional governance of the EU capital market generally or for ESMA in particular. The CMU agenda is likely to have one of three effects on ESMA. First, the CMU agenda may destabilize and disrupt the current evolutionary and experimentalist trajectory of EU capital market institutional governance if it leads to or comes to operate within changed political conditions which support further institutional centralization. Second, the CMU agenda may strengthen ESMA, and reinforce its position as the pre-eminent EU markets authority, by supporting the current incremental and experimentalist development of ESMA and by creating conducive conditions for ESMA's evolution. Third, the CMU agenda may slow the current evolutionary process by obstructing the adoption of necessary supportive reforms.

nancial Supervision Review' A7-0133/2014, 9 March 2014; and IMF, 'Financial Sector Assessment Program, European Union. European Securities and Markets Authority' (Technical Note) March 2013

67 N 26.

68 Action Plan (n 3) 26–27.

69 N 8.

The second and third outcomes, which assume that ESMA's influence, as an administrative actor, is determinative, can be predicted with a degree of certainty. Recent evidence of ESMA's preferences and of the means through which it exerts influence suggests that ESMA is likely to strengthen its soft governance powers over the EU capital market (within or without the CMU agenda) and to increase its influence on EU capital market governance in an incremental and experimentalist manner. ESMA's 2016–2020 'Strategic Orientation' is indicative. It suggests an ESMA determination to set its own priorities as its focus shifts to rule implementation and to the support of supervisory convergence.⁷⁰ Sections IV and V consider ESMA's activities and preferences, how they are likely to shape institutional governance for the EU capital market, and how the CMU agenda may accelerate or disrupt ESMA's current institutional trajectory.

The first and more radical outcome, which assumes that the Member States are the determinative influence, is only likely if the CMU agenda leads to, or operates within, political conditions which are supportive of stronger centralization of institutional governance for the EU capital market. Absent a resetting shock to the EU capital market, on the lines of the banking and subsequent euro-area crises which changed institutional and political conditions such that the ESFS and subsequently Banking Union could be constructed and the related constitutional obstacles surmounted, this is unlikely. Proximate causes for an agenda-changing crisis in the EU capital market can easily be identified (a severe liquidity crisis,⁷¹ perhaps following the failure of a CCP, being the most likely). But the dense rule-book now supporting the EU capital market and the increasing levels of surveillance, including by prudential supervisors, over capital markets,⁷² reduce, at least, the likelihood of a re-setting catastrophic crisis. There is, however, another location for re-setting change: a euro-area-located Financial Union with centralized institutional structures, as discussed in section III.

70 ESMA, 'Strategic Orientation 2016 – 2020' ESMA/2015/935 (2015).

71 Liquidity risks are currently a major preoccupation of regulators globally and of the market, given increasing concerns as to thinning and fragile liquidity, particularly in the bond markets. See, eg, the IMF's 2015 'Global Financial Stability Reports' (April and September 2015 and April 2016), and an October 2015 speech by Bank of England Deputy Governor Shafik on 'Dealing with Change: Liquidity in Evolving Market Structures', 27 October 2015. From a markets perspective see, eg, ICMA, 'European Repo Market Survey', September 2015.

72 Including globally through the FSB's current capital market initiatives, particularly with respect to shadow banking (eg FSB, 'Global Shadow Banking Monitoring Report' 12 November 2015) and, within the EU, through ESMA and the ECB (through the latter's 'Financial Stability Reviews').

III. CMU and Institution Building: CMU and/or Financial Union?

1. CMU and Financial Union

CMU is, on the face of it, primarily concerned with market construction and with the single market in capital.⁷³ But it is also strongly associated with the reinforcement of the single market against the fragmentation risks inherent in Banking Union (predominantly a euro-area construct), and, in particular, against the risks posed to the single market by euro-area caucusing within Banking Union. More specifically, the potential for ‘Brexit’ casts a long shadow over the CMU project. The UK’s concerns as to the potential for euro-area caucusing and for related discrimination against single market Member States who do not form part of the euro area were given clear legal expression recently by the successful action by the UK against the ECB’s clearing policy (which the UK claimed discriminated against non-euro-area central clearing counterparties (CCPs))⁷⁴ and by the declarations in the 2014 MiFID II/MiFIR that Member States not be discriminated against on currency grounds.⁷⁵ A similar inference can be drawn from the July 2015 Joint Council and Commission Declaration, sought by the UK, that the European Financial Stability Mechanism cannot impose a liability on a non-euro-area Member State with respect to financial assistance to a euro area Member State.⁷⁶ The distinct UK concerns as to the potential for Banking-Union-generated forces to reshape governance for the single financial market were clear from the outset of the Banking Union negotiations. The ‘double lock’ voting arrangement which now applies to the EBA Board of Supervisors and which requires a double majority of Banking Union Board members and non Banking Union Board members⁷⁷ were driven

73 Eg Green Paper (n 2), underlining that the objective is a ‘Capital Markets Union for all 28 Member States’ (at 2), and Action Plan (n 3), emphasizing that CMU is designed to ‘build a true single market for capital – a Capital Markets Union’ and that economies with under-developed capital markets should benefit from CMU (at 3). The College of Commissioners has emphasized that ‘CMU is a classical single market project, which should be created by the 28 Member States, for the 28’: Commission Press Release, 28 January 2015.

74 Case T-496/11, *European Central Bank v UK*, 4 May 2015. The General Court of the EU did not address the discrimination question but ruled against the ECB for lack of competence to adopt its policy.

75 In a legally redundant but politically significant recital MiFID II affirms that no action taken by ESMA or an NCA should directly or indirectly discriminate against any Member States as a venue for the provisions or investment services and activities in any currency (recital 139).

76 Council Press Release No. 593/15, 17 July 2015.

77 The reforms were adopted in Regulation (EU) No. 1022/2013 of the European Parliament and of the Council amending Regulation (EU) No. 1093/2010 as regards the

by the UK, while the Bank of England has warned of the risks to the UK from euro-area caucusing.⁷⁸

The February 2016 New Settlement (outlined in section I above) is designed to give legal and political protection to the UK against euro-area caucusing risks and is the European Council's response to the UK's call for legally binding principles 'that safeguard the operation of the Union for all 28 Member States' and which include recognition that the single market must be protected.⁷⁹ The CMU agenda provides another means, however, through which the primacy and integrity of the single market can be asserted. It is hard to avoid the inference that CMU is, in many respects, an expedient EU agenda, allowing the EU to underline the importance of the single market in an area of particular economic importance to the City of London. It is not unreasonable, accordingly, to speculate that the CMU agenda, of itself, is unlikely to lead to radical change to the current institutional settlement for the single capital market.

But another interpretation of the CMU agenda is possible. The important June 2015 Five Presidents' Report on EMU saw the Five Presidents 'borrow' CMU and characterize it as a device for completing EMU.⁸⁰ The Report calls for an 'Economic Union' and (in the more long-term) a 'Fiscal Union' to complete EMU, and sets out high-level reform proposals and time-lines in this regard. But it also calls for a 'Financial Union' and highlights that 'Economic and Financial Union are complementary and mutually reinforcing. ...Progress on these two fronts must be a top priority.'⁸¹ It is not clear at present what a 'Financial Union' might entail. The Report suggests that it could incorporate Banking Union and its structures. But it also suggests that a Financial Union could in addition incorporate CMU in order to diversify risks across countries within EMU, moderate the impact of cross-country shocks, and ensure that monetary policy decisions are transmitted across EMU.⁸² Political and policy reaction to the Report has been muted, perhaps reflecting the political sensitivities and the very significant constitutional and institutional complexities associated with institutional reform (noted below). ECB President Draghi has, however, been clear in his support for the centralization of governance within

conferral of specific powers on the ECB concerning policies relating to the prudential supervision of credit institutions [2013] OJ L287/63.

78 Bank of England, 'EU Membership and the Bank of England' 21 October 2015, 6–7.

79 Letter from UK Prime Minister Cameron to European Council Chair Tusk, 10 November 2015, 2.

80 'Completing Europe's Economic and Monetary Union. Report by Jean-Claude Juncker, in close cooperation with Donald Tusk, Jeroen Dijsselbloem, Mario Draghi, and Martin Schulz' June 2015, 12.

81 At 11.

82 Ibid.

the euro area, although he has also been careful not to call directly for a centralization of capital market governance structures.⁸³ And while the Commission and European Council have emphasized the single market function of CMU, they have both underlined the benefits of CMU in terms of supporting the smooth transmission of monetary policy within the euro area.⁸⁴ The prospect of a Financial Union emerging cannot accordingly be lightly dismissed.

2. *Centralizing Capital Market Governance within a Financial Union?*

It is not clear whether any euro area Financial Union incorporating CMU would imply the mutualization of supervisory risks and costs, and so require a centralized supervision structure and related resolution mechanisms, mirroring Banking Union. The risk diversification required for EMU, and which would support financial stability within the euro area, could well be achieved through a well-functioning single market. But the delicate institutional overtures on Financial Union which are currently being played, and the link being made between the CMU agenda and support of euro area stability, suggest that it is not entirely unreasonable to suggest that CMU, if it becomes tied to Financial Union, may lead to institutional change for the euro area capital market. It may be that the CMU agenda, if political conditions allow, produces a multi-layered institutional governance model, composed of concentric governance circles, with an inner layer composed of discrete institutions for a euro area Financial Union and an outer layer composed of the current structures operating on a pan-EU basis for a single-market-based CMU. It is hard, in this regard, to ignore the ECB's statement that while 'CMU is first and foremost an EU-28 agenda,' enhanced cooperation in other ways could be explored, and that a 'vanguard group' of countries could proceed on the basis of 'enhanced cooperation' and its view that 'the roadmap towards a genuine CMU... should thus include a single capital markets supervisor.'⁸⁵

The ECB's stance is not entirely surprising, even leaving aside the ECB's institutional incentives to claim the Financial Union/CMU agenda. The evo-

83 In a 2015 speech ('Cross-border Markets and Common Governance', Bank of England Open Forum, 11 November 2015, London) ECB President Draghi argued that '[f]or countries that share a single currency and a single market, therefore, the case is clear – I would say almost undeniable – for stronger common governance and deeper institutional integration.' Although the comments relate to the need to complete Banking Union, they chime with the Five Presidents' Report.

84 Action Plan (n 3), 3 noting the ability of CMU to support better shock absorption within the euro area, and European Council Resolution (n 8) para 4, noting CMU as a project of 'shared importance' for the EU-28 and as a priority for completing EMU.

85 ECB (n 8).

lution of EU institutional governance for the financial system has a strongly incremental quality. Institutional design reforms, while often radical in terms of their legacy effects, are typically based on a reshaping of ‘off the shelf’ models. These models are typically dusted down and recast when political and market conditions provide the impetus for the political compromises and for the legal sleights of hand which are typically required of new governance designs, and for the related rebalancing of competences between the EU and its Member States. Thus, the ESAs are based on the ‘Lamfalussy committee’ design model, and the SSM is situated within the ECB, although in each case ingenious legal solutions and political compromises were required to adapt the existing constructs to the new institutional structures. It is not therefore inconceivable that the ESA-, SRM-, and ECB/SSM-templates could be deployed to construct a new form of institutional design for a euro-area Financial Union which sits within a wider CMU. Incrementalism has, of course, limits. CMU and Banking Union have different drivers. The Banking Union reforms are primarily concerned with euro-area risk mutualization, the support of financial stability, and the protection of the euro; the CMU/Financial Union agenda is concerned with risk diversification and single market liberalization. But the increasingly close focus by prudential supervisors globally on the risks to financial stability posed by securities markets, and particularly those risks posed by liquidity contractions, means that speculation as to the wisdom and likelihood of some form of centralized supervision within a Financial Union in order to support efficient risk diversification across the euro area, and in the interests of euro-area financial stability, is not necessarily misplaced.

This is all the more the case as the February 2016 New Settlement makes clear that financial stability has become the new battleground for the holding of territory with respect to euro area/non-euro area financial governance. While the New Settlement affirms that implementing measures relating to supervision and resolution, and with respect to markets and financial institutions, are the province of non-euro-area Member States and their authorities, it also notes that such Member States can ‘join common mechanisms open to their participation’;⁸⁶ the implication that common supervisory and resolution mechanisms for the euro area may develop is clear. There are, however, a number of powerful braking factors – operational, constitutional, and political – which caution against predictions that institutional structures to support mutualized supervision and rescue/resolution of euro-area capital market actors are likely to appear.

The operational challenges alone compel a pause for thought. The single market in capital is far from complete and the degree to which market-based funding is

86 N 7, Annex I, Section A, Economic Governance, para 4.

relied on differs sharply across the Member States, including across the euro area, as has been repeatedly reported.⁸⁷ There is also an immense diversity of actors in the capital markets, ranging from non-financial issuers and counterparties (NFCs), to multi-function systemically-significant global banks with capital market operations, to systemically-significant financial market infrastructures. The related need for nimble and appropriately differentiated supervision is becoming increasingly apparent. The importance of and the challenges raised by proportionality mechanisms, for example, are becoming clear (section IV below). To take another example, how best to calibrate capital market rules to NFCs is increasingly drawing regulatory attention, as is whether such calibration is obscuring the potential for NFCs to generate systemic risk.⁸⁸ The functional logic of centralized supervision is not accordingly strong and the potential economies of scale are not compelling.

Any form of institutional centralization would in addition need to engage with the importance of conduct supervision in the capital markets sphere. While banking supervision is primarily concerned with prudential supervision and related risk management tools, capital market supervision requires close oversight of a vast range of conduct risks, including with respect to market transparency, efficiency, and integrity, and consumer protection. While prudential supervision can rely to a significant extent on remote data collection and monitoring, conduct supervision requires close contact with the day-to-day operations of financial institutions. Centralization would pose significant challenges.

It may be, of course, that any Financial Union would not be so ambitious and would include only those capital market actors with systemic implications and whose failure could disrupt the ability of the euro area to diversify risks: major financial market infrastructures and global investment banks might be appropriate candidates. But here particular difficulties arise with respect to resolution and rescue. The SRM does, of course, include certain major investment banks.⁸⁹

87 Among the many recent discussions see, eg: Commission (EC), 'Initial Reflections on the Obstacles to the Development of Deep and Integrated EU Capital Markets' (Staff Working Document SWD (2015) 13, 18 February 2015); A Giovannini, C Mayer, S Micossi, C Di Noia, M Onado, M Pagano, and A Polo, 'Restarting European Long-term Investment Finance. A Green Paper Discussion Document' (CEPR, Brussels 2015); and European Capital Markets Expert Group, 'Europe's Untapped Capital Market. Rethinking Integration after the Great Financial Crisis' (CEPS/ECMI, Brussels 2016).

88 ESMA, eg, has recently raised concerns as to the divergences across the Member States in how the calibrated rules which govern NFCs under EMIR are applied, and how NFCs are defined: ESMA, 'EMIR Review No. 1' ESMA/2015/1251 (2015).

89 Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions

But a specific regime would be required for the resolution of systemic infrastructures, and here the political difficulties are likely to be significant given the fiscal risks posed by CCPs in particular. The sensitivities posed by the coordination of CCP supervision under EMIR are already clear. EMIR requires that CCPs, for the first time in the EU, be supervised through colleges of supervisors and in accordance with the protocols and rule-book established under EMIR.⁹⁰ ESMA's first report on CCP college operation was broadly positive, but it warned of coordination difficulties, and, in particular, of a reluctance by college chairs in some instances to share information, which could disrupt college decision-making.⁹¹ The design of a related resolution/rescue system, given the potentially severe fiscal implications of a CCP default, is, accordingly, likely to generate very significant political difficulties. Although the Commission published its pathfinder Consultation in 2012⁹² there has been little progress since then. Informal consultations and impact assessment work is underway⁹³ and the Commission has committed to producing a proposal⁹⁴ but progress so far has been slow.

The constitutional obstacles are similarly significant. The *Meroni* doctrine prevents any EU agency – such as ESMA, a variant thereof, or any new agency for the euro area – from being granted the wide range of discretionary supervisory powers which capital markets supervision demands. ESMA's current suite of direct supervisory powers is heavily confined by legislative and administrative conditions (for example, the conditions which apply to exercise of its new powers in relation to position oversight in the commodity derivative markets: MiFIR, Article 45) which would be difficult to apply in any operationally sensible manner to a full-scale markets supervisor. The ECB remains a candidate, certainly. Article 127(6) TFEU could support the transfer of capital market supervision powers to the ECB and, as an EU institution established under the Treaty, the ECB does not operate under the *Meroni* constraint. But other difficulties arise, not least that Article 127(6), which allows for supervisory powers to be conferred on the ECB, only addresses prudential supervision and does not provide a competence in respect of conduct supervision.

and certain investment firms within the framework of a Single Resolution Mechanism and a Single Resolution Fund [2014] OJ L225/1, art 2(1)(c).

90 EMIR, arts 19–21.

91 ESMA, 'ESMA Review of CCP Colleges under EMIR' ESMA/2015/20 (2015).

92 Commission (EC), 'Consultation on a Possible Recovery and Resolution Framework for Financial Institutions other than Banks', 5 October 2012.

93 Commission (EC), 'Roadmap, Framework for Resolution of non-bank Financial Institutions,' April 2015.

94 CMU Green Paper (n 2) 23.

An entirely new institution could be established under Article 352 TFEU. But the UK's opposition to centralized capital market supervision⁹⁵ makes it politically highly unlikely that a new institution would be constructed, as Article 352 requires a unanimous vote. Notwithstanding the political protections contained in the New Settlement, the UK is likely to be reluctant to support the construction of any new euro area institution under Article 352, even though the New Settlement also 'acknowledges' that non-euro-area Member States 'will not create obstacles' to the deepening of EMU.⁹⁶

So where does this leave the institutional governance debate on the CMU agenda and on the institutional settlement for the EU capital market? Current political conditions and a host of braking factors suggest that the institutional discussion should be framed by the single market context and, accordingly, with reference to the current institutional structure supporting the single market in capital. These conditions may, of course, change – particularly if the CMU agenda proves to have significant transformative effects and if the degree of capital market integration materially deepens, particularly within the euro area;⁹⁷ if a successful bedding in of the Banking Union reforms strengthens the logic for some form of centralized euro area supervision; and if the New Settlement comes to be regarded as providing robust protection for non-euro-area Member States. A multi-speed governance arrangement may follow, with top-down centralized structures operating within the euro area and along side bottom-up (coordination/ESMA-based) structures for the single market more generally. Such an outcome would lead to the co-existence of potentially competing institutional arrangements within a highly complex institutional eco-system. But it might also provide an evolutionary and pragmatic response to the lack of completion of both the single market and of the euro area, and to the current political divergence across the EU as to the merits of further integration, which is now crystallized within the New Settlement.

The likelihood of any such institutional arrangement emerging must remain remote, however, not least given the current political uncertainties relating to 'Brexit'. The following sections accordingly consider how the current institutional governance settlement for the EU capital market might develop, drawing on ESMA's preferences and activities as evidenced by recent empirical experience. They suggest that an ESMA-driven, incremental, and experimental outcome, which leads to more centralization of regulatory and supervisory governance, is most likely.

95 Bank of England, *Response to the European Commission Green Paper: Building a Capital Markets Union* (2015) 2.

96 N 7, Annex I, Section A, Economic Governance, Introduction.

97 For a sceptical perspective see Moloney (n 9).

IV. Regulatory Governance and the CMU Agenda

1. Regulatory Governance: the Institutional Settlement

There has been a marked centralization in the regulatory governance of the EU capital market since the establishment of ESMA in 2011. This reflects the political commitment at the ‘level 1’ legislative level to a detailed ‘single rule-book’⁹⁸ and to mandate the administrative process accordingly.⁹⁹ But this centralization also has an evolutionary and incremental quality, reflecting ESMA’s influence as an administrative actor and its increasing regulatory capacity.

Since 2011 ESMA has produced a vast range of what might be termed ‘quasi-regulatory products’ in the form of BTS proposals (at level 2), Technical Advice (at level 2), and Guidelines and other soft measures (at level 3), through which it has exerted a decisive influence on the single rule-book for the EU capital market. In his September 2015 report to the Parliament’s ECON committee, for example, ESMA Chairman Maijoor reported on the adoption by ESMA in the previous year of 65 extensive BTSs (primarily under MiFID II/MiFIR, EMIR, and the Market Abuse Regulation) and 56 lengthy sets of Technical Advice.¹⁰⁰ In a number of cases, ESMA’s quasi-rule-making activities have led to it exercising significant influence over the shape of the EU capital market. Its BTS proposals on which derivative instruments must be cleared through CCPs under the 2012 EMIR, for example, are reshaping the structure of the EU derivatives market. A significant milestone was reached in August 2015 when the Commission endorsed ESMA’s first BTS imposing a CCP clearing obligation – on certain interest rate swaps denominated in euro, sterling, yen, and the US dollar.¹⁰¹ ESMA has also, through its quasi-regulatory activities, established a single set of reporting standards for derivatives transactions. ESMA Chair Maijoor has recently characterized these initiatives as

98 On level 1 law-making over the crisis period see, eg, L Quaglia, ‘Banking Union as Holy Grail: Rebuilding the Single Market in Financial Services, Stabilizing Europe’s Banks, and ‘Completing’ Economic and Monetary Union’ (2013) 51 *JCMS* 103 and E Ferran, ‘After the Crisis: The Regulation of Hedge Funds and Private Equity in the EU’ (2011) 12 *EBOLR* 379. For a policy perspective, see House of Lords, European Union Committee, Fifth Report of Session 2014–2015, ‘The Post-Crisis EU Regulatory Framework: do the pieces fit?’ (2015).

99 On the drivers of the EU’s commitment to a ‘single rule-book’ for the EU capital market see Moloney (n29) ch X and E Ferran, ‘Crisis-driven Regulatory Reform: Where in the World is the EU Going?’ in E Ferran, N Moloney, J Hill, and C Coffee, *The Regulatory Aftermath of the Global Financial Crisis* (CUP, Cambridge (2012)) 1.

100 ‘Statement by ESMA Chairman Maijoor to the ECON Committee’ ESMA/2015/1349, 14 September 2015.

101 C(2015) 5390.

supporting an ‘OTC Derivatives Union’ within which there is a high level of regulatory and supervisory consistency – and which could act as a model for CMU.¹⁰² Similarly, ESMA’s highly granular, instrument-specific September 2015 BTS proposals for the massive new cross-asset-class transparency regime under MiFID II/MiFiR are likely to have major implications not just for the transparency of the EU capital market, but also for its liquidity, particularly in the bond markets.¹⁰³

There are few signs of this administratively-driven trajectory toward regulatory centralization flattening out. The immediate pressure to adopt new administrative rules is receding, as is reflected in ESMA’s current focus on supervisory convergence activities (section V). Nonetheless, the co-legislators are still granting wide-ranging mandates for administrative rules¹⁰⁴ and this can be expected to continue over the CMU agenda period, as is clear from the proposed securitization regime. In addition, ESMA’s appetite for shaping the single rule-book through soft law measures appears to be considerable, in part reflecting its incentives to reinforce its regulatory capacity as an administrative actor and its position as the source of technocratic regulatory expertise in the EU, and in part reflecting the complexities and ambiguities of the single rule-book and industry and NCA needs for consistency and clarification. ESMA has, since 2011, adopted a large suite of Guidelines (adopted under ESMA Regulation Article 16 and subject to NCA ‘comply or explain’ requirements), usually to support the consistent application of rules.¹⁰⁵ Guidelines provide ESMA with a powerful lever for centralizing regulatory governance as their adoption is not dependent on a level 1 mandate and is not subject to the inter-institutional oversight mechanisms which apply to Technical Advice and BTSs. As discussed further below, ESMA is also proving itself adept in managing the risks to its regulatory capacity which arise from the somewhat shaky accountability and legitimacy controls on ESMA Guidance.

102 ESMA Chairman Maijoor, Speech on ‘Clearing the way towards an OTC derivatives union’ ESMA/2015/1417, 22 September 2015.

103 ESMA, ‘Proposed Regulatory Technical Standards and Implementing Technical Standards MiFID II/MiFiR. Final Report’ ESMA/2015/1464 (2015).

104 Such as, eg, the mandates in the proposed Benchmark Regulation (Commission (EC), ‘Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts’ COM (2013) 141, 18 September 2013). The Regulation was agreed by the Council and Parliament on 25 November 2015.

105 Recent examples include its ‘Guidance on Commodity Derivatives’, ESMA/2015/675 (2015). See further Moloney (n 29) 929–935.

Whether or not regulatory governance should continue to follow this centralizing trajectory is not the subject of this discussion, although the scale of political, industry, and institutional support for the single rule-book, recently reinforced through the CMU agenda, suggests this debate is somewhat sterile. From an institutional governance perspective, and specifically with reference to the influence of administrative governance, stakeholder support for ESMA's role, and for the related centralization of regulatory governance through administrative means, appears to be secure.¹⁰⁶ In a significant political and institutional show of support for ESMA, there has been a marked movement across the level 1 mandates for administrative rule-making from the use of 'standard' administrative level 2 rule-making (which is controlled by the Commission and in relation to which ESMA provides Technical Advice) to the use of BTSs (in relation to which ESMA proposes BTSs and benefits from a range of procedural protections, although BTSs are adopted/endorsed by the Commission). Certainly, ESMA's position as a technocratic expert is being reinforced. The important September 2015 BTS proposals issued by ESMA on the MiFID II/MiFIR market microstructure rules,¹⁰⁷ and ESMA's extensive September 2015 review of the EU credit rating agency industry,¹⁰⁸ for example, evidence the development of a sophisticated ESMA rule-design capacity, as well as an extensive empirical and stakeholder consultation capacity.

Regulatory governance for the EU capital market can, accordingly, be expected to continue to centralize over the CMU agenda period, through administrative channels, and without formal institutional reforms. Nonetheless, there are indications that stresses are emerging which may come to threaten the ability of the EU to support the EU capital market by means of a robust administrative regulatory process or, at least, which may lead to an administrative process which struggles to achieve outcomes in an optimal manner. While there are counter indications that ESMA's ability to generate refinements informally and in a responsive and experimentalist manner is significant and increasing, this ability is constrained by procedural formalities and by Treaty restrictions. The CMU agenda may, however, distract the co-legislators from necessary reforms. The following sections consider the nature of the stresses on the administrative regulatory process and in light of the CMU agenda.

106 See, eg, the discussions at n 66.

107 N 103.

108 ESMA, 'Technical Advice, Competition, Choice, and Conflicts of Interest in the Credit Rating Agency Industry' ESMA/2015/1472 (2015).

2. *Institutional Tensions*

The Commission and ESMA

Institutional tensions remain potentially significant with respect to level 2 rule-making for the EU capital market, reflecting the strong incentives of the Commission, in particular, but also of the European Parliament, to protect their prerogatives in relation to administrative rule-making. There have been only a few instances where the Commission has revised or vetoed BTSs proposed by ESMA or not followed ESMA's Technical Advice. But these episodes have typically generated some market consternation, given the extensive consultation and impact assessment ESMA engages in and concerns as to the opacity of the process through which the Commission adopts level 2 rules and BTSs and as to the potential politicization of a process which is designed to be administrative and technical. Shortly after ESMA's establishment, the Commission did not follow important elements of ESMA's Technical Advice relating to the level 2 2013 Alternative Investment Fund Managers Directive (AIFMD) Regulation,¹⁰⁹ generating something of an industry fracas and concerns as to the injection of political interests once the technical, ESMA-led process had completed. The BTS process has also generated tensions between the Commission and ESMA. The EMIR process, in particular, proved troublesome, leading on one occasion to a sharp public exchange of views between the Commission and ESMA.¹¹⁰

A degree of tension between the Commission (the constitutional location of administrative rule-making power) and ESMA (the location of technical expertise) is to be expected and can be productive where it leads to careful attention to institutional mandates and powers and to useful mutual oversight. But risks to good governance arise where institutional difficulties slow down rule-making for the EU capital market or fetter ESMA as the location of technical expertise. Given the *Meroni* restrictions, it is neither reasonable nor realistic to call for ESMA to be empowered to act as an administrative rule-maker. It is also increasingly clear that the level 2 process is organic and dynamic and that both ESMA and the Commission are, reflecting the predictions of experimentalist governance, engaged in an iterative and often constructive process to ensure the system operates as effectively as possible within current constraints.

ESMA and the Commission have recently agreed, for example, on an 'early legal review' process which is designed to ensure that legal mandate and other difficulties which may obstruct the adoption by the Commission of an administrative rule proposed or advised by ESMA are flagged early on.¹¹¹ Similarly,

109 Commission Delegated Regulation (EU) No. 231/2013 [2013] OJ L83/1.

110 Moloney (n 29) 920–921 and 926–927.

111 Letter to ESMA Chairman Maijoor to Director General Faull, 15 May 2015.

the Commission and ESMA can be regarded as forming something of an ‘axis of technocracy’ which can generate pragmatic remedial solutions. The emergence in November 2015 of a coordinated position between ESMA and the Commission to the effect that a delay to the implementation date of MiFID II/MiFIR be adopted given the complexities and costs of implementation reflects not only a welcome pragmatism in the Commission’s and ESMA’s approach to MiFID II/MiFIR, but also a productive degree of coordination.¹¹²

Ad hoc initiatives of this nature go some way to addressing the risks to effective rule-making which are generated by the current institutional governance arrangements which support administrative rule-making for the EU capital market. But the CMU agenda provides a moment when more formal and stable reforms can be contemplated. Greater clarity is needed in level 1 mandates, for example, to avoid the risk of level 1 discussions being continued or re-opened during the level 2 phase and thereby subverting the technical administrative process. The potential for administrative inefficiencies must also be removed. The nature of a Commission ‘revision’ to a proposed BTS, which triggers a subsequent ESMA consultation and review process, should, for example, be clearer. To take a final example, the process through which the Commission adopts level 2 rules and BTSs should be significantly more transparent, particularly where the Commission diverges from ESMA. The likelihood of the CMU agenda crowding out technical reforms of this nature, however, is high.

The European Parliament and ESMA

The less documented but no less pivotal ESMA/European Parliament relationship (the Parliament, along with the Council, exercises veto powers over Regulatory Technical Standards (RTSs) and has long been careful to protect its prerogatives with respect to administrative rule-making), which was initially strong,¹¹³ appears to be experiencing some stresses, perhaps reflecting ESMA’s growing authority and regulatory capacity as the EU’s capital markets agency.

112 The possibility of a delay was raised by ESMA Chairman Maijor in his evidence on MiFID II to the Parliament’s ECON committee (ECON Scrutiny Speech – MiFID 2, ESMA/2015/1639, 10 November 2015)) and the Commission’s support was subsequently reported (J Brunson and P Stafford, ‘EU overhaul of financial market rules to be delayed’ *Financial Times* online, 10 November 2015). The co-legislators agreed to the delay in May 2016.

113 As is clear from the ECON committee’s repeated support for the conferral of direct supervisory powers on ESMA.

The January 2016 Balz Resolution¹¹⁴ suggests some Parliament concern to exert tighter control over ESMA. While broadly supportive of ESMA and calling for ESMA to be closely engaged in the upcoming review crisis-era measures, the Resolution called on ESMA and the Commission to ensure they operate within the limits of their level 2 empowerments. The Resolution also raised concerns as to the implications of the new ESMA/Commission informal ‘early legal review’ process for the Parliament’s oversight powers. It additionally called for more transparency over internal ESMA decision-making and for the Parliament to be provided with early drafts of proposed BTSs and Technical Advice.¹¹⁵ Despite its independence guarantee, ESMA already operates under significant institutional constraints, including the potential chilling effect of Commission representation on its Board of Supervisors. The opening of its internal deliberations to Parliament’s scrutiny could further and significantly undermine its independence.

Parliamentary concern has also been generated with respect to ESMA’s soft quasi-regulatory powers and particularly with respect to Guidelines. ESMA Guidelines can generate constitutional conundrums as to their vires, legitimacy, and accountability, particularly where Guidelines are not closely related to level 1 rules and as definitive interpretive authority over EU law lies not with ESMA but with the Court of Justice of the EU. Legal certainty risks can also arise, as arguably was the case where the NCAs of five major markets in the EU chose not to comply with ESMA’s Guidelines on Short Selling.¹¹⁶ Guidelines were identified as a concern by the 2016 Balz Resolution which called for less reliance on Guidelines, particularly where their adoption was not expressly mandated by a legislative act.¹¹⁷ But Guidelines, however troublesome, provide a means for bridging between EU capital market needs for certainty and clarity on technical and at times ambiguous rules, particularly in new areas of regulation, and the cumbersome level 2 rule-making process. In particular, they allow ESMA – if in an informal manner – to address speedily material ambiguities in level 1 and level 2 measures, pending regulatory reform. ESMA has, however, proved to be adept in managing the risks to its position (and to the market more generally where Guidelines to be obstructed). It has recently adopted a position on its approach to Guidelines adoption which affirms the need for ESMA to meet all the Article 16 ESMA Regulation criteria governing the adoption of Guidelines, for Guidelines to have a clear basis in EU law, and for Guidelines to be within ESMA’s scope.¹¹⁸ ESMA also appears increasingly to be consulting with the Commission before it issues

114 N 23.

115 N 23, at paras 48 and 52.

116 ESMA, ‘Guidelines Compliance Table’ ESMA/2013/765 (2013).

117 N 23, para 54.

118 Summary of Conclusions ESMA Board of Supervisors 2014/BS/89, 20 May 2014.

Guidelines on potentially contested areas, as was the case, for example, with its 2015 Guidance on the definition of derivatives under MiFID I.¹¹⁹

It may accordingly be possible for ESMA to effectively manage its relationship with the European Parliament through responsive and informal mechanisms such as these. But the effectiveness risks attendant on ESMA's ambiguous position as a technocratic quasi-rule-maker without formal rule-making power remain. These risks may become all the greater if the European Parliament succeeds in gaining greater oversight over ESMA's internal deliberations with consequent risks to ESMA's independence. Here the CMU agenda may prove to have useful decelerating effects, drawing the co-legislators' attention elsewhere to substantive regulatory reforms.

3. Technical Resilience and Flexibility

A host of more technical difficulties are also becoming apparent. Over the crisis-era ESMA struggled with rigid timelines for the adoption of BTS proposals and Technical Advice. Level 1 mandates have, at times, been unclear. Perhaps most importantly, the level 2 process cannot nimbly adjust or calibrate technical rules where market conditions so require. The highly technical nature of much of the crisis-era level 2 rule-book, in combination with the very limited empirical data available on which these rules could be based (with respect to the EMIR and MiFID II/MiFIR level 2 rules in particular), makes it highly likely that some rules will require adjustment as the market implications become clear. But there is no bespoke procedure for speedily adjusting level 2 rules.

EMIR provides a useful example. It is not possible under current procedures for ESMA to speedily withdraw or suspend the EMIR clearing obligation from a particular instrument (which obligation takes the form of an RTS) where market conditions (such as the default of the CCP which clears the instrument) so require. Counterparties could, however, face significant risks were they required to clear instruments which could not, in practice, be cleared. ESMA has highlighted the significant risks to market stability which could follow and called for an expedited process which would allow it to make a decision, through its Board of Supervisors, withdrawing a RTS, subject to procedural conditions, within a clear and limited framework, and after appropriate consultation.¹²⁰ To take another example, the 2014 MiFID II/MiFIR level 2 transparency rules, primarily in the form of RTSs, may require suspen-

119 ESMA/2015/675. ESMA initially requested the Commission to take action to address the ambiguities relating to the definition, following which the Commission suggested that ESMA adopt Guidelines.

120 ESMA Review of EMIR. No. 1 (n 88).

sion if, as is possible, unforeseen and drastic liquidity contractions are generated by the new rules.

The current generation of level 2 RTSs include, for example, detailed rules governing which assets must be cleared through CCPs and traded on trading venues; the exact percentage limits on the commodity derivative positions which may be held by persons; and the particular levels of securitized derivatives trading which render that asset class liquid or illiquid. These highly technical and instrument-specific RTSs have little in common with the broad rules initially associated with level 2 rule-making for the EU financial system. Highly technical and dependent on robust empirical data, their ability to shape markets is very significant. But so too are the risks which regulatory error in their construction, or regulatory reliance on poor quality empirical data, pose. A suspensive power is accordingly functionally compelling. It remains to be seen, however, whether the institutions, and particular the Commission, will support the conferral of a suspensive decision-making competence on ESMA, which would bring ESMA closer to the character of a traditional regulator.¹²¹ The legal difficulties alone are considerable. An ESMA power to suspend an RTS would, for example, imply the exclusion of the Commission, European Parliament and Council, all of which would have been formally engaged, reflecting Treaty requirements, in the original RTS adoption process. The *Meroni* difficulties are also significant given the degree of discretion such a suspensive power would confer on ESMA. But resolution of this conundrum is imperative if the highly technical rule-book, much of which is based on speculative empirical data, is not to generate prejudicial effects.

4. *ESMA, Regulatory Governance, and the CMU Agenda*

In the five years since its establishment ESMA has proved itself to be a technically-expert quasi-regulator and has displayed a significant capacity to intensify the single rule-book, including through its soft law activities. It has also shown itself to be adept in navigating institutional obstacles nimbly, and in using fluid and experimentalist techniques which have supported an ongoing centralization of regulatory governance. The changing nature of EU capital market law, and in particular the growth of highly technical market-shaping rules, is exposing a need for additional technocratic capacity, as is underlined by the growing need for a suspensive rule-making power. Changes may, accordingly, follow which enhance ESMA's ability to shape and centralize regulatory governance in an evolutionary manner. The CMU agenda may accel-

121 The US Commodity Futures Trading Commission, eg, is empowered to issue 'no action' letters, in effect suspending relevant rules, where required.

erate this process of centralization. It is likely to lead, for example, to a number of additional mandates for level 2 rule-making and thereby to enhance ESMA's ability to shape regulatory governance. The execution of the CMU agenda may also lead to a greater dependence on ESMA and thus to a lessening of the emerging tensions between ESMA and the Commission and European Parliament.

But the strains in the level 2 process are becoming apparent after five years of experience. While ESMA has proved itself to be creative in responding to the strains in its operating environment, formal changes to the process are necessary. The CMU agenda may prove disruptive if it distracts the political process from the need to deliver the necessary administrative efficiencies.

V. Supervisory Governance and CMU

1. Supervisory Governance: the Institutional Structure

The more radical possibilities for change to the institutional settlement governing the EU capital market over the CMU agenda period relate to supervisory governance. It is more likely, however, that the developments in this sphere will also be incremental and responsive, reflecting the predictions of experimentalist governance.

As noted in section II above the supervision of the EU capital market operates through a de-centralized mechanism and is managed through a network of home/host NCAs. ESMA plays a largely coordinating role. Its suite of supervisory convergence powers is designed to empower ESMA to drive supervisory convergence, raise supervisory standards, and support coordination and cooperation between NCAs. Key powers in this regard include those relating to peer review (ESMA Regulation Article 30), information gathering (Article 35), participation in colleges of supervisors (Article 21), and the support of a common supervisory culture (Article 29). ESMA also has a series of direct supervisory powers, although these are typically of a last resort/deterrent nature. The most significant ones are those under Articles 17–19 of the ESMA Regulation and in relation to breach of EU law (Article 17), emergency conditions (Article 18), and binding mediation (Article 19); with respect to short selling under the Short Selling Regulation,¹²² and under MiFIR with respect to product intervention and position management. In all cases, strict conditionality applies. The new MiFIR Article 40 product intervention power, for example, only activates where ESMA action is necessary to address a

122 Regulation (EU) No. 236/2012 of the European Parliament and of the Council on short selling and aspects of credit default swaps [2012] OJ L86/1.

significant investor protection concern or threat to the orderly functioning and integrity of financial/commodity markets or to the stability of the whole/part of the EU financial system; EU regulatory requirements do not address the risks; and the relevant NCA(s) have not taken adequate action. In addition, the ESMA action must not have detrimental effects on financial market efficiency or investors which are disproportionate to the benefits; it must not create a risk of regulatory arbitrage; and must be taken after consultation with relevant commodities authorities, where relevant. Detailed level 2 rules are to amplify these conditions. In two areas – the supervision of credit rating agencies and of the trade repositories which hold OTC derivatives market data – ESMA is the direct and exclusive EU supervisor. In this last capacity ESMA operates within, reflecting *Meroni* dictates, a highly detailed rule-book, including with respect to its enforcement activities.

The ESAs' supervisory powers – and particularly the direct supervisory powers – generated most controversy over the 2010 ESA negotiations, given that supervision can lead to conflict between EU and Member State interests given the potential for fiscal risks. Similarly, ESMA's distinct supervisory powers under the Short Selling Regulation and MiFIR have been highly contested, with the UK in particular doubtful as to the necessity for and Treaty/*Meroni* resilience of these powers and taking ultimately unsuccessful action before the Court of Justice of the EU against ESMA's Short Selling Regulation powers. Supervision has not, however, been ESMA's major concern over the first five years of its operation, reflecting the demands associated with the construction of the crisis-era rule-book. Supervision can be expected to acquire more prominence, not least given the calls from the ESFS Review and the IMF for a closer focus by ESMA on supervision.¹²³ ESMA has also recently placed supervision, and in particular supervisory convergence, at the core of its Strategic Orientation for 2016–2020.¹²⁴

Accordingly, how might the current institutional settlement governing supervision, and in particular ESMA's role, evolve over the CMU reform period? The question is all the more germane as, if there is significant progress towards a CMU, additional risks to financial stability may follow if funding becomes more dependent on market-based sources¹²⁵ – although stability benefits should also follow from the greater diversification of funding away from bank sources. As is the case with regulatory governance, an incremental intensification of supervisory governance at EU level, driven by ESMA and at the administrative level, can be expected to occur over the CMU agenda period.

123 See the discussions at n 66.

124 N 70.

125 ECB (n 8) 3. The Bank of England, the counterweight to the ECB outside Banking Union, has raised similar concerns: n 95, 2.

‘Big bang’ reforms, in the form of the conferral of new supervisory powers on ESMA or of the construction of a new supervisory authority are much less likely. Nonetheless, ESMA’s administrative influence can be predicted as leading to a significant degree of centralization, particularly with respect to supervisory convergence, albeit that ESMA’s ability to shape pan-EU supervision may be limited by legal ambiguities the resolution of which may be neglected given competing demands under the CMU agenda.

2. *Direct ESMA Supervision and the CMU Agenda*

The CMU agenda – as currently constituted – is not a risk mutualization project. It does not require direct, centralized supervision (on the lines of the Banking Union arrangements) in order to support related risk mutualization. As considered in section III, the political, constitutional, and operational obstacles to such centralized supervision are considerable, even for the euro area. But what does ESMA’s current suite of direct powers suggest as to the future direction of supervision for the single EU capital market?

With respect to ESMA Regulation Article 17 (ESMA action following NCA breach of EU law), there is little experience yet with ESMA’s powers to impose decisions on NCAs in breach of EU law and to impose related decisions on market participants. ESMA has yet to take such action, although requests have been made for ESMA action; the ESA Board of Appeal has affirmed that Article 17 is a discretionary power.¹²⁶ The non-action by ESMA is not entirely surprising or prejudicial. As ESMA’s 2012 Decision on the Article 17 process¹²⁷ underlines, the Article 17 power sits at the top of a pyramid of powers and practices which ESMA can use to support compliance by NCAs with EU law. These include the adoption of Guidelines; peer review; and the support of the development of a common approach to rule application and supervision through the Board of Supervisors. The Article 17 Decision clarifies the scope of Article 17 and reserves this power for serious breaches of EU law,¹²⁸ but it

126 Decision of the Board of Appeal BoA 2013-008, 24 June 2013. The Board of Appeal emphasized that the art 17 power was discretionary, that EBA (the ESA engaged), as a small body, was not in a position to investigate every admissible complaint, and that, following the correct application of its discretion, EBA was empowered not to take action even where the request to take action was admissible and related to a breach of EU law.

127 ESMA/2012/BS/87. The Decision addresses issues such as the admissibility criteria for art 17 action and defines the scope of the art 17 power.

128 The ‘investigation factors’ which ESMA will consider prior to taking art 17 action include whether the alleged breach undermines the foundations of the rule of law, concerns a repeated infringement, and whether it may have a significant, direct impact on ESMA’s objectives: 2012 Article 17 Decision (n 127), Annex 2.

also identifies the other mechanisms, such as peer review or binding mediation, which can act as alternative channels for addressing breach of EU law difficulties where appropriate.¹²⁹ Softer enforcement measures, such as peer review, are being deployed more robustly by ESMA (as noted further below). In addition, flagrant breach of EU law is unlikely to be a regular occurrence across the Board of Supervisors. More difficulties are likely to arise with respect to discretionary applications/interpretations of EU law, in relation to which the Article 19 binding mediation power engages. Finally, while Article 17 provides ESMA with a strong deterrent capacity, the risks associated with ESMA proceeding publicly against a member NCA are likely to be significantly greater than any benefits. Ultimately, Article 17 is likely to operate best as a deterrent and signalling device. ESMA's restraint on Article 17 accordingly suggests a commitment to a slower and more evolutionary centralization of supervisory convergence and a well-judged wariness of more radical but disruptive interventions.

ESMA's capacity to shape pan-EU supervisory practices in an optimal manner is more likely to be weakened by the difficulties associated with ESMA Regulation Article 19 (ESMA's power to impose decisions following a binding mediation between NCAs). Recourse to binding mediation can be expected to increase if NCAs take different approaches to rule implementation and supervision. While the single rule-book governing the EU capital market is becoming ever more detailed, room remains for interpretation and discretion. This is particularly the case with respect to the 'proportionate' application of rules; proportionality mechanisms are a particular feature of the crisis-era rule-book and are beginning to receive close institutional attention.¹³⁰ While proportionality mechanisms provide an important safety valve for NCAs with respect to rule implementation, differences in interpretation can be expected. EBA, for example, recently faced significant difficulties in reaching an agreed EBA position on whether a 'proportionate' application of the CRD IV remuneration rules allowed for rules to be dis-applied entirely.¹³¹ Binding mediation is accordingly likely to become of increasing importance given the likelihood of different NCA approaches emerging as to how proportionality requirements apply. The binding mediation tool is also of particular importance where

129 Ibid, Annex 2.

130 Eg, the evidence by SSM Chairperson Nouy before the European Parliament on 'The principle of proportionality: application in the Single Supervisory Mechanism' (Letter from SSM Chairperson Nouy to ECON Committee Member Giegold, 2 October 2015); and the concern expressed by the January 2016 Balz Resolution (n 23, para 58).

131 EBA, 'Consultation on Draft Guidelines on Sound Remuneration Policies' EBA/CP/2015/03 (2015) (the Guidelines have since been adopted (EBA/GL/2015/22)). EBA subsequently adopted an Opinion which called for legislative revisions to CRD IV to make clear the scope of the proportionality mechanism (EBA/Op/2015/25).

NCA's fail to reach joint decisions within colleges of supervisors. The binding mediation tool has not, however, been regularly used by the ESAs: ESMA has not deployed it, while EBA has reported on only two instances of mediation.¹³² This may reflect the legal risks which the Article 19 tool generates.

These legal risks are generated by the ambiguities as to whether the Article 19 power to impose a binding mediation decision applies where an NCA, in good faith, exercises a discretionary power in a manner which it regards to be in accordance with EU law, and another NCA disagrees with the interpretation, leading to the need for mediation. In such circumstances, can ESMA impose a decision governing the exercise of discretion by NCAs? Reflecting the concern of the UK that Article 19 not become a vehicle for fettering NCA discretion, recital 32 of the ESMA Regulation provides that, in cases where the relevant EU law confers discretion on NCAs, ESMA decisions under Article 19 cannot replace the exercise in compliance with EU law of that discretion. The legal effect of this recital is ambiguous. A sounder legal footing for a restrictive interpretation of Article 19 comes from the 2014 SRM Regulation which amends the EBA Regulation (which otherwise follows the ESMA Regulation) to provide that EBA's Article 19 powers cannot apply to national resolution authorities where these authorities exercise discretionary powers or make policy choices (SRM Regulation, Article 95). The Commission has committed to examining the scope of Article 19, reflecting some ESA concern as to its scope.¹³³ But the power remains ambiguous. The lack of clarity does not, as yet, appear to have caused significant difficulties for ESMA. Nonetheless, the achievement of the CMU agenda requires that some form of mechanism, short of recourse to the Court of Justice of the EU, be available for addressing inter-NCA conflicts relating to the application of EU capital markets law. The CMU agenda has, for example, underlined the importance of smooth cross-border investment fund capital allocation and fund marketing to the deepening of market finance in the EU. But where difficulties arise with respect to interpretations of the highly complex fund rule-book, ESMA's powers are limited. The CMU agenda may, however, reduce the appetite of the co-legislators for technical reforms of this nature, particularly given the sensitivities which Article 19 generates for the UK.

With respect to the conferral of additional supervisory powers on ESMA, as is suggested in section III it is unlikely that ESMA will be transformed into some form of 'SSM' for the capital markets. It is more likely that ESMA will acquire additional direct supervisory powers, given the ease with which the co-legislators have conferred additional discrete supervisory powers on ESMA in an

132 Its 2014 Annual Report reported on two successful instances of mediation in 2014.

133 EBA Chairman Enria called for a clarification of the ESA Regulations to remove textual ambiguities which restrict the practical effectiveness of art 19: Speech on 'The Single Market after Banking Union' 18 November 2013.

incremental manner since 2011 (including with respect to trade repositories (2012 EMIR) and product intervention and position management (2014 MiFID II/MiFIR)). But any such additional conferrals of power are likely to be made on an ad hoc and incremental basis. The Commission, while showing some enthusiasm for considering the EU centralization of supervisory powers over shadow banking and CCPs,¹³⁴ has not, under the CMU agenda, called for additional powers to be conferred on ESMA; it has focused instead on supervisory convergence.¹³⁵ ESMA has been similarly circumspect. While it has suggested that it is ‘uniquely positioned to develop a European supervisory approach that could have strong benefits for pan-European actors’, ESMA has also underlined that ‘while clearly not asking for new areas of supervision’, it ‘stands ready to assume such new tasks’ should they be conferred.¹³⁶ Functionally, is difficult to argue at present that achievement of the CMU agenda requires some degree of EU centralization of supervision for particular market segments – even assuming the *Meroni* and other political/institutional/fiscal constraints could be addressed. Networked prospectus approval, for example, appears to be working reasonably well,¹³⁷ while ESMA’s supervisory convergence activities in this area are intensifying¹³⁸ and more detailed harmonization of NCA supervisory powers is proposed under the Commission’s 2015 Prospectus Regulation Proposal.¹³⁹ The failure of a critical financial market infrastructure – such as a major trading venue or CCP – could, of course, generate an existential threat to the stability of the EU capital market and drive change. But the complexity of the fiscal and constitutional difficulties which such EU centralization of supervision would generate suggests that these difficulties are unlikely to be addressed under the CMU agenda, absent a re-setting change to market conditions.

3. Supporting Supervisory Convergence

The most immediate influence on the institutional development of supervisory governance for the EU capital market is likely to be exerted by ESMA’s approach to supervisory convergence.

134 Commission ESFS Review (n 26).

135 CMU Action Plan (n 3) 26.

136 ESMA, Response to the Commission Green Paper on Building a Capital Markets Union 2015/ESMA/865, 21 May 2015, 5.

137 ESMA’s 2012 Prospectus Peer Review, eg, examined the practical procedures adopted to review prospectuses and found full application of relevant ESMA Good Practice Principles in 25 Member States.

138 Including a current peer review on prospectus approval.

139 N 4.

Stronger supervisory convergence (or the application of consistent supervisory practices across NCAs and the encouragement of best practices) has long been an aim of EU capital market law and policy, but it has been recently identified as essential to the achievement of CMU. The Commission in its CMU Action Plan highlighted supervisory convergence; called on ESMA to strengthen its supervisory convergence activities; and underlined the importance of consistency in supervision and in supervisory outcomes to the success of the CMU agenda.¹⁴⁰ The European Parliament is also a supporter of stronger supervisory convergence.¹⁴¹ Supervisory convergence as the main influence on the evolution of supervisory governance for the EU capital market has much to commend it. It requires dialogue and cooperation between NCAs with respect to the sharing of best practice, the improvement of standards, and the enhancement of coordination. It is based on responsive supervisory learning and coordination, facilitated by ESMA, rather than on the top-down imposition of standards or centralized exercise of supervisory powers. It also accommodates a degree of diversity where necessary to reflect diverse market conditions.

The prominence given to supervisory convergence by the CMU agenda suggests that ESMA will be the major influence on the development of supervisory governance for the EU capital market over the CMU agenda period. ESMA's incentives to pursue a vigorous supervisory convergence programme are strong. The constitutional space is relatively clear; a relatively limited suite of powers is needed for ESMA to act effectively; the opportunities supervisory convergence creates for constructive dialogue between ESMA and NCAs are potentially considerable, as is the potential for strengthening ESMA's Board of Supervisors and for pursuing a supranational, EU agenda; and the risk of conflict with ESMA's key institutional stakeholders is relatively low. NCAs, for example, can be expected to be (relatively at least) supportive of supervisory convergence measures, not least as such measures may give NCAs leverage for demanding additional supervisory resources and related powers at national level, while the Commission and Parliament are supportive. It is not accordingly surprising that ESMA recently placed the support of supervisory convergence at the core of its 2016–2020 Strategic Orientation;¹⁴² identified supervisory convergence as a means through which it can support the CMU agenda;¹⁴³ underlined that from 2016 onwards its focus will increasingly shift from rule-making to implementation and that supervisory convergence will be

140 CMU Action Plan (n 3).

141 European Parliament Resolution (n 66).

142 N 70, 7–8.

143 Its Board of Supervisors has, eg, highlighted that supervisory convergence could act as a substitute for regulation: Summary of Conclusions ESMA Board of Supervisors ESMA/BS/59, 19 March 2015.

a core focus of its activities;¹⁴⁴ and adopted its first supervisory convergence work programme.¹⁴⁵ ESMA has also highlighted risk assessment, data collection, and peer review as key priorities for the next period.¹⁴⁶ This new focus on supervisory convergence is likely to lead to greater central steering of NCA supervisory practices by ESMA. By way of illustration, two techniques used by ESMA to support supervisory convergence are considered below.

Peer Review

Peer review has come to form a key element of the post-crisis global settlement on supervision, as reflected in the Financial Stability Board's (FSB) regular and intensifying peer review exercises and the commitment by FSB members to regular 'FSAP' reviews of their regulatory, supervisory, and enforcement systems by the IMF/World Bank.¹⁴⁷ ESMA's formal Articles 17 and 19 powers are ill-suited to supporting the embedding of good supervisory practices. Peer review, which identifies and seeks to encourage good practices, and which can have a coercive element, is likely to be significantly more effective in strengthening supervisory convergence across the EU capital market.

The ESMA Regulation Article 30 peer review regime requires ESMA periodically to organize and conduct peer review analyses of NCAs' activities to further strengthen consistency in supervisory outcomes. ESMA must also develop methods to allow for objective assessment and comparison between NCAs, and ESMA peer review should assess, *inter alia*: the adequacy of NCA resources and governance arrangements, including with regard to the effective implementation of EU rules and NCA capacity to respond to market developments; the degree of convergence in the application of EU law and supervisory practices and the extent to which supervisory practices achieve the objectives of EU law; and good practices developed by NCAs which might be of benefit to other NCAs. The coercive effect of peer review is also addressed. ESMA may subsequently issue guidelines and recommendations to NCAs and NCAs are under an obligation to 'endeavour to follow' these guidelines and recommendations. The results of the peer review may also be disclosed publicly, subject to the agreement of the relevant NCA.

Peer review is currently carried out through ESMA's Supervisory Convergence Standing Committee and in accordance with the ESMA Protocol and Methodology on Peer Review.¹⁴⁸ Since its establishment, ESMA has under-

144 ESMA, '2016 Work Programme' ESMA/2015/1475 (2015) 5.

145 ESMA/2016/2013.

146 Strategic Orientation 2016–2020 (n 70) 7–8.

147 FSB, 'Framework for Strengthening Adherence to International Standards' (2010).

148 ESMA, 'ESMA Review Panel Methodology' ESMA/2013/1709.

taken a number of peer reviews, including with respect to the market abuse regime, the prospectus authorization process, and the application of the important Money Market Fund Guidelines;¹⁴⁹ it has also conducted a mapping exercise on contingency powers for crises.¹⁵⁰ Over 2014, peer review exercises were carried out with respect to ESMA's automated trading Guidelines, MiFID I rules on 'fair, clear, and not misleading' disclosures, and MiFID I rules on best execution, while 2015 saw peer reviews on short selling and market-making supervisory practices; prospectus approval; MiFID I suitability requirements; and CCP college operation.¹⁵¹

Exemplifying ESMA's strengthening ability to support convergence, and a productive Board of Supervisors dynamic, ESMA peer review is becoming increasingly intensive, regular, and robust. By contrast with EBA, for example, which has been slower to engage with peer review (reflecting, perhaps, the degree of harmonization achieved by the SREP and the complexities of SSM/single market dynamics given the ECB's role in overseeing supervision within the SSM), peer review is a standing item on ESMA's Board of Supervisors meetings. The tone of ESMA peer review is becoming more robust, attesting to the ability of the Board of Supervisors to peer review its member NCAs in an effective manner. ESMA's initial reviews focused on mapping different approaches to supervision. The recent 2015 peer review on supervision of best execution requirements, however, is notable for its detail and for the directness of its message.¹⁵² ESMA found, for example, that convergence, and the level of NCA monitoring of best execution, were relatively low and that NCAs experienced problems in prioritizing resources. It also identified the six NCAs which had been subject to onsite inspection by ESMA and made specific and public recommendations. In a related development, which provides an additional indication of ESMA's strengthening ability to take a coercive position against its member NCAs, ESMA, for the first time, has criticized short selling measures adopted by one of its member NCAs. Under the 2012 Short Selling Regulation¹⁵³ ESMA is empowered to provide an opinion on short selling measures adopted by NCAs. January 2016 saw ESMA, for the first time, issue a negative opinion in which it found emergency action by the Greek supervisor not to be appropriate or proportionate.¹⁵⁴ Board of Supervisors dynamics can change, but current indications seem to augur well for ESMA's ability to

149 ESMA/2012/270 and ESMA/2013/805; ESMA/2012/300; and ESMA/2013/476, respectively.

150 ESMA/2011/261.

151 See ESMA Annual Report for 2014 and ESMA Chairman Maijor Annual Statements to the ECON Committee, September 2014 and 2015.

152 ESMA/2015/494.

153 Regulation No. 236/2012 [2012] OJ L86/1.

154 ESMA, Opinion, 11 January 2016 (ESMA/2016/28).

deploy peer review (and similar review) mechanisms to support strong supervisory convergence across the single capital market, and to adopt a hierarchical and coercive approach where appropriate.

Colleges of Supervisors

Colleges of supervisors are most strongly associated in EU financial governance with banking governance and with the group/subsidiary/systemic branches colleges of supervisors which are required under CRD IV/CRR and in which EBA plays a key oversight role.¹⁵⁵ But they also play a role in capital market governance. ESMA, like all the ESAs, is conferred with a range of powers to support supervisory colleges. It must contribute to promoting and monitoring the efficient, effective, and consistent functioning of colleges of supervisors and to fostering the coherence of the application of EU law among colleges (ESMA Regulation, Article 21(1)). ESMA staff are empowered to participate in the activities of colleges, including on-site examinations carried out jointly by two or more NCAs (Article 21(1)). ESMA is also to take the lead in ensuring a consistent and coherent functioning of colleges, taking account of the systemic risk posed by financial market participants (Article 21(2)). ESMA may establish and manage information systems for colleges, initiate and co-ordinate EU stress tests to assess the resilience of financial market participants, and promote effective and efficient supervisory activities. ESMA may also request further deliberation by a college where it considers a college decision would lead to an incorrect application of EU law or not contribute to convergence in supervisory practices (Article 21(2)).

To date, colleges have not played a major role in capital market governance in the EU, given the dominance of home NCA control and of cross-border activity through branches and services which obviates the need for colleges (colleges typically govern home NCA/home NCA coordination within a group where cross-border activity is carried out through subsidiaries). There is, however, one important exception: the 2012 EMIR requires colleges of supervisors for CCPs and confers a related set of powers on ESMA. The ESMA experience with the EMIR colleges – while limited thus far – provides accordingly important indicators as to how ESMA is likely to shape the operation of these operationally-critical colleges and to shape, thereby, the further centralization of supervisory governance.

Under EMIR, CCP colleges are charged with a range of tasks, chief among

155 See, eg, EBA, ‘Accomplishment of 2015 EBA Colleges Action Plan and 2016 Action Plan’ (2016).

them CCP authorization and model review. ESMA is a member of all CCP colleges (EMIR, Article 18) and facilitates the adoption by colleges of the 'authorization opinion' on which CCP authorization depends (Article 19). ESMA is also charged with proposing BTSs and adopting Guidelines governing CCP colleges; with peer review of CCP colleges; and with the coordination of CCP stress testing. Eighteen CCP colleges have now been constituted under EMIR, and ESMA has been quick to establish its authority in this area. It has, for example; produced Guidelines on the written agreements required of colleges and adopted an Opinion on college composition and voting which restricts the ECB/SSM to one college seat (the ECB/SSM called for two – as the bank of the currency of issue, and as supervisor).¹⁵⁶ ESMA's first (2015) review of CCP colleges suggests close engagement by ESMA with the operations of CCP colleges,¹⁵⁷ as well as an ESMA appetite for robust and direct reporting on CCP college weaknesses. ESMA reported on a generally good level of cooperation and engagement within colleges, but it also warned that college chairs could be more constructive with respect to information-sharing and that where information was not shared NCAs were more likely to abstain on or vote against key college decisions.

4. *A Disruptive Environment and Institutional Tensions?*

The extent of ESMA's ability to shape supervisory governance is in part a function of its institutional environment. In many respects that environment is currently stable. In particular, the current institutional, and also political and market, support for supervisory convergence provides ESMA with the opportunity to strengthen its supervisory capacity without it trespassing on unstable constitutional or political territory or it encountering significant institutional resistance. But the SSM may become a source of disruption.

ESMA has considerable incentives to establish and reinforce its position as the capital market/conduct supervision counterweight to the SSM, at least with respect to EU-level coordination.¹⁵⁸ These incentives are likely to become all the stronger as prudential regulators globally, and within the EU, come to focus on the stability risks posed by capital markets and to encroach on the traditional territory of securities/capital market regulators. ESMA appears, for example, to have been robust in refusing the ECB two seats on the CCP

156 ESMA/2013/661 and ESMA/2015/838.

157 N 91. ESMA has, eg, identified issues of concern with respect to CCP compliance.

158 N Moloney, 'Banking Union and the Implications for Financial Market Union in the EU: Convergence or Divergence' in Busch and Ferrarini (n 30) 524.

colleges of supervisors which ESMA oversees.¹⁵⁹ Whether or not ESMA and ECB/SSM relations are likely to become disruptive is not yet clear. It seems reasonable to suggest that a cooperative approach will develop, not least given ESMA's status as the location of a massive data-set on the EU capital market and its now well-evidenced technical expertise. Recent skirmishes may simply evidence the inevitable tensions generated as institutions – even where there is a great disparity in power – learn to play a new institutional game. ESMA and the ECB/SSM have, for example, successfully negotiated a Memorandum of Understanding on institutional cooperation¹⁶⁰ and ESMA Board of Supervisors meeting minutes suggest a cooperative and productive dynamic. Nonetheless, the potential for tension remains, as is clear from the ECB's recent call for the regulatory regime governing EMIR colleges, in which ESMA plays a key role, to be revised in light of the role of the SSM.¹⁶¹

VI. Conclusion

This article speculates that, reflecting the insights of experimentalist governance theory, the CMU agenda is not likely to lead to radical changes to the institutional governance of the EU capital market. A 'bottom-up,' ESMA-led, incremental, iterative, but increasingly intensifying process of convergence is likely to be observed, given that ESMA's interests, powers, and preferences are likely to be the major influence on how institutional governance develops over the CMU-agenda period. In this regard, the evolution of institutional governance for the EU capital market reflects the evolution of institutional governance more generally: the preferences of administrative actors are increasingly coming to rank alongside national political preferences as the major influences on how institutional governance for the financial system develops. This fluid process of governance evolution is, and without re-setting the current institutional settlement for EU financial governance, likely to lead to significantly greater EU centralization – at the administrative level – of regulatory and supervisory governance for the EU capital market. There are, however, obstructions which may disrupt this evolutionary process and which the CMU agenda is unlikely to address.

This discussion does not speculate more generally as to whether or not this form of incremental institutional centralization is functionally optimal for the EU capital market or for the achievement of the CMU agenda. The degree of centralization which is likely to be observed is likely to generate more technically-

159 ESMA/2015/838.

160 ESMA Press Release, 28 January 2016.

161 The ECB 'strongly believes' EMIR should be revised to reflect the specific role of the SSM: ECB, 'Response to the Commission Consultation on EMIR', 2 September 2015.

informed rule-making and stronger consistency in supervisory practices across the EU. The opportunities for NCAs to diverge, and for national experimentation, are likely to decrease. The interests of and risks generated by large pan-EU groups and systemically-significant actors can be expected to preoccupy ESMA to a greater extent, particularly given the greater stability risks associated with more intense capital market activity. The long over-shadowed retail market agenda can be expected to remain in the shadows – notwithstanding the Commission’s CMU-driven commitment to a new approach to the retail financial services.¹⁶² Similarly, EU financial governance might be expected to become less sensitive to smaller firms and to specialist capital market actors. It can, however, be predicted with a reasonable degree of certainty that the greater consistency and clarity in the single rule-book which should follow from further centralization of regulatory governance through ESMA should enhance legal certainty and the operating environment for firms, particularly pan-EU groups. With respect to supervisory governance, greater consistency, driven by ESMA, in supervisory practices should similarly reduce transaction costs.

Neither does this discussion speculate as to whether the accountability mechanisms which apply to ESMA will remain fit for purpose as the nature of ESMA’s role evolves. EU accountability mechanisms over agencies are typically designed to reflect the Treaty balance of power and the interests of the Member States and of the Council, Commission, and Parliament;¹⁶³ ESMA is, for example, formally accountable to the European Parliament and Council (ESMA Regulation, Article 3). But as ESMA’s role and influence shifts, closer scrutiny is required of its accountability structures. Should, for example, a new form of board governance be designed, which allows for oversight by independent actors or representatives of particular constituencies? And if so, how might these accountability mechanisms fit within current Treaty restraints and requirements? There are multiple ways of designing accountability structures, as is clear from cognate developments in the sphere of international financial governance.¹⁶⁴ As the EU gropes its way towards a new administrative law on EU financial system governance, the CMU agenda could usefully expand to include an examination of the accountability of the structures of EU financial governance.

The degree of institutional governance centralization predicted by this discussion is likely to occur independently of the CMU agenda. It remains to be

162 As reflected in Commission (EC), ‘Better products, more choice and greater opportunities for consumers and businesses’ (Green Paper on Retail Financial Services) COM (2015) 630, 10 December 2015.

163 See, eg, M Everson, ‘A Technology of Expertise: EU Financial Services Agencies’ (2012) LEQS WP No. 49/2012.

164 Barr (n 28).

seen whether the CMU agenda injects an accelerating factor by providing ESMA with a favourable operating environment. Conversely, CMU may distract the EU political and policy process from necessary institutional reforms. And the prospect of a euro area Financial Union driving a major resetting change to institutional governance cannot be discounted, even if the array of political, institutional, and constitutional obstacles is formidable.