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Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope

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Abstract: *The new European Financial Supervisory Authorities have received much attention in the literature, particularly due to their exceptional emergency decision-making powers. By contrast, this article explicitly chooses to focus on these agencies' less explored yet equally crucial role: their (quasi-)rule-making responsibilities. While being less striking at first sight than their emergency counterparts, these rule-making powers are considerable, carry significant consequences, and raise some interesting dilemmas and concerns. This article complements the previous contribution by going at a lower level of specification and zooming in on a crucial case for studying rule-making by agencies as the Authorities constitute a culmination of agency rule-making powers, as well as agency powers, more broadly. The article will analyse the Authorities' main (quasi-)rule-making powers and the relevant procedures. It will specifically investigate their role with respect to the adoption of regulatory and implementing technical standards, as well as guidelines and recommendations. The article also identifies and highlights a set of problematic issues that arise, threatening to jeopardise the legitimacy and credibility of their rule-making.*

I Introduction: A New Age of Agencification?

In 2010, in the wake of the financial crisis, three European Supervisory Authorities (ESAs) were set up: the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA).[1] Existing 'shortcomings in the area of cooperation,

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[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331/12, 15.12.2010; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331/48, 15.12.2010; Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/77EC, OJ L 331/84, 15.12.2010.

coordination, consistent application of Union law and trust between national supervisors'[2] were laid bare by the financial crisis, and the perceived need for a more efficient and integrated system of European regulation and supervision became ever more pressing. In response, a package of financial reforms for micro- and macro-prudential supervision were introduced, amounting to 'a watershed for financial regulation in Europe'.[3] The new financial supervisory Authorities, together with the national supervisors, make up the system of financial micro-prudential supervision in the EU.

In the context of the crisis-driven reform of the EU financial system, a new set of European agencies was thus created, set aside from earlier agencies by the broader range of powers that they are *formally* granted. The new financial Authorities are not exactly entirely 'new', however. They are created from the previous network-based Lamfalussy Level 3 committees, which operated until 2011 and whose powers, unlike the Authorities', fell short of being able to issue binding rules. While not entirely new, in light of their institutional predecessors, in terms of their powers however, the Authorities are regarded as a significant shift both within the context of EU agencification phenomenon and also for the regulation of financial markets.

Within the EU agencification process, the ESAs break the mould, formally at least, in terms of their unprecedentedly wide-ranging powers compared with earlier agencies, as well as the heavy emphasis in their founding regulations on their independence, and have been likened to the more powerful US authorities.[4] Unlike any other European agencies before them, in exceptional circumstances, the ESAs are able to direct binding decisions to national supervisory authorities, as well as to overrule them and issue decisions directly to individual financial institutions in a Member State. As a result, they have been qualified by the European Parliament (EP) as a 'fundamental shift in the way banks, stock markets and insurance companies are policed as of 2011'.[5] Simultaneously, however, their powers have also given rise to anxiety[6] as well as raising criticism about the adequacy of their legal basis (ie Article 114 TFEU), 'a somewhat shaky competence for a radical institutional reform'.[7] What is more, it seems that their mandate might be enhanced even further, in an ad hoc and impromptu basis, with the EP further noting that they 'will be able to grow as events require'.[8]

However, in addition to their exceptional and far-reaching emergency powers, these Authorities also have considerable (quasi-)rule-making powers, drafting technical

[2] Recital 1, Preamble of Regulation (EU) No 1093/2010, OJ L 331/12, 15.12.2010; Regulation (EU) No 1094/2010, OJ L 331/48, 15.12.2010; Regulation (EU) No 1095/2010, OJ L 331/84, 15.12.2010 (hereafter ESAs Founding Regulations).

[3] E. Ferran, 'Understanding the New Institutional Architecture of EU Financial Market Supervision', (2011) *University of Cambridge Legal Studies Research Paper Series No. 29/2011*, at 32.

[4] E. Chiti, 'An Important Part of the EU's Institutional Machinery: Features, Problems and Perspectives of European Agencies', (2009) 46 *Common Market Law Review* 5, 1395–1442.

[5] European Parliament, Press Release, 'Parliament gives green light to new financial supervision architecture', REF.: 2010092, 22.9.2010.

[6] R. Sullivan, 'Anxiety grows over new powers for ESMA', *Financial Times*, available at http://www.ft.com/intl/cms/s/0/cb034c38-9103-11df-b297-00144feab49a.html#axzz1x65GMQeB.

[7] N. Moloney, 'EU Financial Market Regulation after the Global Financial Crisis: "More Europe" or More Risks?' (2010) 47 *Common Market Law Review* 5, 1317–1383, 1341. See also E. Fahey, 'Does the Emperor Have Financial Crisis Clothes? Reflections on the Legal Basis of the European Banking Authority', (2011) 74 *The Modern Law Review* 4, 581–595.

[8] European Parliament (2010), *op cit*.

standards, endorsed into binding law by the European Commission, as well as being able to adopt 'strong' guidelines and recommendations, as we shall see below. Given the specific and rather exceptional circumstances under which the first type of powers can be exercised, it is particularly the latter type of powers that are the ones to watch out for. While being less striking at first sight than their emergency counterparts, these rule-making powers are nevertheless considerable as well as carrying significant consequences, precisely by virtue of their 'workaday' character by comparison to emergency powers employed in restricted and exceptional circumstances.[9] It is on the analysis on these, perhaps at first sight less exceptional, but not less salient, powers that this article focuses.

This article, thus, complements the previous contribution by Eduardo Chiti by going at a lower level of specification and zooming in on a crucial case for studying rule-making by agencies. The specific focus is warranted by the fact that these Authorities constitute a culmination of agency rule-making powers, as well as, as mentioned above, a culmination in agency powers, more broadly. The article sets out to analyse the Authorities' main (quasi-)rule-making powers and the relevant procedures. It will specifically investigate their role with respect to the adoption of regulatory and implementing technical standards, as well as guidelines and recommendations. The article identifies and highlights a set of problematic issues that arise in respect of the Authorities' rule-making, and more precisely in terms of the legitimacy and credibility of their rule-making.

II The ESAs and Rule-Making: Meroni-Tailored

In terms of rule-making, the new Authorities exercise two main types of powers. First of all, they can adopt *draft technical standards*, which can take the form of (1) regulatory technical standards and (2) implementing technical standards, reflecting the Treaty distinction between delegated acts, Article 290 TFEU and implementing acts, respectively Article 291 TFEU. This is, in fact, the first reference post-Lisbon to the Article 290/291 measures in the constituent act of a European agency. Second, by virtue of their mandate, the Authorities can also adopt soft law measures, taking the form of the so-called *guidelines and recommendations*.

Thus, the financial supervisory Authorities are in fact *quasi-rule-makers* as they cannot adopt horizontal rules of general application but rather draft technical standards, which need to be endorsed into binding law by the European Commission and soft law measures. This set-up is not uncontroversial. On the one hand, the Authorities are clearly being recognised and flagged for their significance and potential in terms of non-legislative rule-making, envisaged to 'lead to a significant intensification of delegated rule-making',[10] have the potential to 'profoundly affect the way in which day-to-day financial supervision is conducted',[11] and carry 'the real potential for centralisation'.[12] At the same time, the rule-making design, relying on Commission

[9] N. Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market—A Tale of Two Competences: Part (1) Rule-Making', (2011) 12 *European Business Organisation Law Review* 1, 41–86.
[10] N. Moloney (2010), *op cit*, 1345.
[11] E. Ferran (2010), *op cit*, 45
[12] N. Moloney (2011), *op cit*, 49.

endorsement, has been criticised[13] as being unfit for purpose, unduly limiting the ability of these bodies to meet their declared objectives, indicative of a gap between 'what is politically and economically desirable and constitutionally feasible'.[14] It is often proclaimed as unsatisfactory, and characterised as 'under-ambitious', 'a lost opportunity', 'flawed' and 'troublesome'.[15]

These limitations on the Authorities' rule-making powers clearly reflect Meroni[16] restrictions, which have defined, be it for legal or in fact political reasons, the EU agencification process. In the Meroni case, dating from 1958, the Court issued a ban on the delegation of discretionary powers, and provided that only the delegation of clearly defined, executive powers was permitted under the Treaty so as not to upset the institutional balance of powers. The doctrine has been used, among others, by the Commission and its legal service to prevent the granting of autonomous powers to agencies,[17] and has been interpreted as amounting to an overall ban on the adoption of horizontal regulatory measures of general application by agencies. The Commission's recurring references in its documents to 'European regulatory agencies'[18] are to this extent highly misleading.

The new Authorities' rule-making powers attest to the ongoing relevance of Meroni and the limits placed on rule-making by agencies, albeit they do stretch the boundaries of the legal doctrine to the maximum. First of all, the Meroni logic is clearly visible in the fact that ESAs' rule-making is subject to the Commission's endorsement. Reflecting Meroni restrictions, the financial supervisory Authorities cannot adopt binding horizontal rules of general application but rather *draft* technical standards. While the founding regulations emphasise the ESAs 'highly specialised expertise',[19] as well as stress that they are the actors 'in close contact with and knowing best the daily functioning of financial markets',[20] their technical standards nevertheless only acquire binding force through adoption by the Commission; as in the case with other agencies before them, the Commission remains the ultimate decision-maker and the Authorities lack direct rule-making powers.

Second, beyond design, the Meroni line of argumentation also crops up in the wording of the relevant legislation, particularly through a recurring emphasis on the fact that the standards adopted by Authorities will not entail policy choices. For instance, the ESAs founding regulations explicitly stress that regulatory and respectively implementing technical standards 'shall be technical, shall not imply strategic

[13] eg E. Ferran (2010), *op cit*; E. Fahey (2011), *op cit*.

[14] E. Fahey (2011), *op cit*, 593.

[15] N. Moloney (2011), *op cit*.

[16] Case 9/56, *Meroni & Co, Industrie Metallurgiche SpA v High Authority* [1958] ECR 133.

[17] R. Dehousse, *Misfits: EU Law and the Transformation of European Governance*, (2002) Jean Monnet Working Paper 2/02, 13, available at http://centers.law.nyu.edu/jeanmonnet/archive/papers/02/020201.html.

[18] European Commission, 'Communication from the Commission. The operating framework for the European Regulatory Agencies', COM (2002) 718 final, Brussels, 11.12.2002; European Commission, 'Communication from the Commission to the European Parliament and the Council. European agencies—The way forward', COM (2008) 135 final, Brussels, 11.3.2008.

[19] Recital 22, Preamble Regulation (EU) No 1093/2010, OJ L 331/12, 15.12.2010; Regulation (EU) No 1095/2010, OJ L 331/84, 15.12.2010; Recital 21, Preamble Regulation (EU) No 1094/2010, OJ L 331/48, 15.12.2010.

[20] Recital 23, Preamble Regulation (EU) No 1093/2010, OJ L 331/12, 15.12.2010; Regulation (EU) No 1095/2010, OJ L 331/84, 15.12.2010; Recital 22, Preamble Regulation (EU) No 1094/2010, OJ L 331/48, 15.12.2010.

decisions or policy choices'.[21] Similarly, the Omnibus Directive, for instance, specifies that '[m]atters subject to technical standards should be genuinely technical, where their development requires the expertise of supervisory experts. (. . .) Technical standards should not involve policy choices'.[22]

Despite these Meroni limitations clearly present in the rule-making design, with the Authorities falling short of being able to adopt binding regulatory measures, it will be seen below that their rule-making powers, albeit *quasi*-rule-making in nature, are nevertheless considerable and certainly exceptional in the EU agencification context, more specifically and unprecedentedly in respect of the manner in which they restrict the Commission in its exercise of delegated and implementing powers. Let us examine these procedures more closely below, as well as some of the issues they raise.

III Powers and Procedures

The basic structure of the rule-making procedures in which ESAs are involved is formalised, as laid out in the ESAs founding regulations. These procedures—for the adoption of technical standards as well as guidelines and recommendations—and the various steps they involve will be laid out in turn below.

A Draft Technical Standards: Restricting the Commission's Powers

The Authorities adopt draft technical standards, which can take the form of regulatory and implementing technical standards. The procedural framework is for the most part analogous, although there are some significant differences, which will be highlighted, where appropriate, below.

The ESAs have the sole *power of initiative* of draft regulatory standards. It is the Authorities that submit a draft to the Commission—subject to prior consultation obligations in the form of open public consultations and the obligation to request the opinion of their relevant stakeholder group as well as cost–benefit analysis requirements.[23] The Commission cannot adopt a regulatory technical standard without a draft from the Authority, and the only exception to this is if the latter fails to submit a draft within the time limits.[24] The Commission is, thus, severely restricted in its power to initiate technical standards and shape the regulatory agenda.

Once the draft is submitted, the Commission may decide not to endorse it, or endorse it in part or with amendments.[25] However, the leeway of the Commission to depart from or not to endorse the Authorities' draft is again subject to limitations. The founding regulations clarify that if the Commission decides not to endorse a draft

[21] Arts 10 and 15 of ESAs Founding Regulations. Also in the Preamble to the regulations, in respect of draft regulatory technical standards 'the elaboration of draft regulatory technical standards, which do not involve policy choices'.

[22] Recital 12, Preamble Omnibus Dir I, Dir 2010/78/EU, OJ 2010 L 331/120.

[23] Art 10(1) for regulatory technical standards and Art 15(1) for implementing technical standards of ESAs Founding Regulations.

[24] Art 10(3) for regulatory technical standards and Art 15(3) for implementing technical standards, ESA's Founding Regulations.

[25] Art 10(1) for regulatory technical standards and Art 15(1) for implementing technical standards of ESA's Founding Regulations.

or to endorse it in part or with amendments, it has to send it back to the Authority, as well as *explain its reasons for non-endorsement or amendments to the Authority*.[26] In other words, the Commission is placed in the position where it has to justify itself to the agency. What is more, in the specific case of draft regulatory technical standards, the preambles to the founding regulations further specify that they should be 'subject to amendment only in very restricted and extraordinary circumstances', and three specific circumstances are identified, albeit broad ones, restricting further the room for manoeuvre of the Commission: 'Draft regulatory technical standards would be subject to amendment *if they were incompatible with Union law*, *did not respect the principle of proportionality* or *ran counter to the fundamental principles of the internal market* for financial services as reflected in the *acquis* of Union financial services legislation'.[27]

What is more, the Commission also cannot unilaterally revise the Authorities' draft. The founding regulations explicitly stress that '[t]he Commission may not change the content of a draft regulatory standard prepared by the Authority without prior coordination with the Authority'.[28] An identical provision is in place for draft implementing standards. The Commission has to send the draft back to the agency, which has a period of six weeks, during which it may amend the draft technical standard and resubmit it. It is only at the end of this period, if the Authority has not submitted an amended draft, or has submitted one, which is not amended in line with the Commission's proposed amendments, that the Commission can adopt the technical standard with the amendments it wants.[29]

In such a situation, in the case of draft regulatory technical standards, further checks are present. In line with the controls introduced by Article 290(2)(b) TFEU, the regulatory standard will only enter into force if the EP or the Council has not objected to the act within a certain period from the date of notification, as set by the legislative act. This period is set by the founding regulations to one month if the regulatory standard adopted by the Commission is the same as the draft submitted by the agency, and longer—that is up to three months and extendable by other three months—at the initiative of the EP or the Council if the regulatory standard diverges from the agency draft.[30] In other words, there are incentives for the final act adopted by the Commission to correspond to the one introduced by the agency; to the contrary, stricter checks are in place.

If the Commission does not endorse a draft regulatory standard or amends it, the Commission has to inform the Authority, the EP and the Council, stating its reasons.[31] What is more, in such a situation, 'where appropriate', the EP or the Council may invite the responsible Commissioner, together with the chairperson of the ESA,

[26] Art 10(1) for regulatory technical standards and Art 15(1) for implementing technical standards of ESA's Founding Regulations.

[27] Recital 23, Preamble of Regulation (EU) No 1093/2010, OJ L 331/12, 15.12.2010 and Regulation (EU) No 1095/2010, OJ L 331/84, 15.12.2010. Recital 22, Preamble of Regulation (EU) No 1094/2010, OJ L 331/48, 15.12.2010.

[28] Art 10(1) for regulatory technical standards and Art 15(1) for implementing technical standards of ESAs Founding Regulations.

[29] Art 10(3) for regulatory technical standards and Art 15(3) for implementing technical standards of ESAs Founding Regulations.

[30] Art 13(1) of ESAs Founding Regulations.

[31] Art 14(1) of ESAs Founding Regulations.

within one month of the notification for a meeting 'to present and explain their differences'.[32] This is exceptional insofar as the *Commission* may actually be requested *to appear for a hearing* to explain itself and its differences with the agency under the scrutiny of the EP or the Council.

Interestingly, not only are the checks on delegated legislation by the EP and the Council stricter when the Commission departs from the agency draft, but what is more, when differences with the agency arise (be it due to Commission's amendments or non-endorsement), a new arrangement for the control of delegated legislation is introduced. Other than the revocation of delegation, Article 290 TFEU foresees only one other check on delegated legislation: the power to prevent its entry into force. Joint hearings of the Commission and the agency's chairperson, as the ones introduced by the ESAs founding regulations, were not foreseen by Article 290 TFEU.

The Commission is clearly dissatisfied with the restrictions introduced in the financial sector on its power to adopt implemented legislation. It has taken to recurrently inserting its objections in its proposals for changes to various pieces of sectoral legislation: 'The Commission wishes to recall the Statements in relation to Articles 290 and 291 TFEU it made at the adoption of the Regulations establishing the European Supervisory Authorities, according to which "[a]s regards the process for the adoption of regulatory standards, the Commission emphasises the unique character of the financial services sector, following from the Lamfalussy structure and explicitly recognised in Declaration 39 to the TFEU. *However, the Commission has serious doubts whether the restrictions on its role when adopting delegated acts and implementing measures are in line with Articles 290 and 291 TFEU*" '.[33]

It is, thus, interesting to observe, despite 'à- la- Meroni' limitations and the fact that agencies are 'only' quasi-rule-makers, how far the room for manoeuvre of the European Commission to adopt delegated and implementing acts is limited by the rule-making framework. While perhaps when viewed from a financial markets perspective the Authorities' rule-making powers fall short of what was deemed necessary in the current crisis context, from a more institutional and *agencification* perspective, the powers that the Authorities exercise are nevertheless far-reaching. This throws into sharp relief an issue raised by Hofmann as to the role of agencies in respect of delegated and implementing acts, as recipients of this function reserved to the Commission, and exceptionally to the Council, in the absence of an express recognition of this in the Treaty.[34] This gap between the treaty text and legal realities becomes even more evident here.

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[32] Art 14(2) of ESAs Founding Regulations.

[33] Emphasis added by the author. See, for instance, Proposal for a Directive of the European Parliament and of the Council amending Dir 2003/71/EC and 2009/138/EC in respect of the powers of the EIOPA, and the ESMA, COM (2011) 8 final, Brussels, 19.1.2011; Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, COM (2011) 452 final, Brussels, 20.7.2011; Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse), COM (2011) 651 final Brussels, 20.10.2011.

[34] H. Hofmann, 'Legislation, Delegation and Implementation under the Treaty of Lisbon: Typology Meets Reality', (2009) 15 *European Law Journal* 482–505.

B 'Strong' Guidelines and Recommendations

In addition drafting to technical standards, with the aim to 'establish consistent, efficient and effective supervisory practices',[35] the Authorities also have the power to issue guidelines and recommendations addressed to national competent authorities or financial institutions. As with technical standards, these measures are made subject to procedural requirements: the establishing regulations provide for open public consultations, proportionate in relation to the scope, nature and impact of guidelines and recommendations and cost–benefit analysis. These are not mandatory, however: it is at the ESAs' discretion to conduct cost–benefit analysis as well as open public consultations, and request opinion or advice from the relevant stakeholder group 'where appropriate'.[36] Although these guidelines and recommendations are legally not binding, they cannot simply be ignored by national competent authorities or financial institutions.

The founding regulations explicitly emphasise that competent authorities and financial institutions are required to 'make every effort to comply'[37] with the Authorities' guidelines and recommendations. To this end, financial institutions can be *required* by the Authority's guideline or recommendation *to report* 'in a clear and detailed way' whether they are complying with the guideline or recommendation.[38] The national competent authorities are *obliged to inform* the Authority within two months of the issuance of a guideline or recommendation whether they comply or intend to comply with the guideline/recommendation. In the event that they do not comply or intend not to comply, they are further *obliged to state reasons*. Thus, in the event of non-compliance, the national supervisors have to explain themselves to the European Authority. The likelihood of compliance is further strengthened by the threat of *public disclosure of non-compliance*. The Authority will publish the fact that the national competent authority does not comply or intend to comply.[39] It is left at the latitude of the Authority to decide on a case-by-case basis whether to also publish the reasons provided by the national authority for non-compliance.

The strength of the guidelines and recommendations is further bolstered by additional public instances of 'naming and shaming'. The Authority is required to inform the EP, the Council and the Commission in its annual report of the guidelines and recommendations issued, 'stating which competent authority has not complied with them, and outlining how the Authority intends to ensure that the competent authority follows its recommendations and guidelines in the future'.[40]

'Naming and shaming' is, thus, envisaged as a strategy to engender compliance, giving teeth to formally non-binding guidelines and recommendations. The threat of negative publicity can serve as a sanctioning mechanism.[41] In the financial sector, reputation is core to the functioning of the market, and is a critical asset of regulators and individual institutions alike. Therefore, in this area, such 'naming and shaming'

[35] Art 16(1) of ESAs Founding Regulations.
[36] Art 16(2) of ESAs Founding Regulations.
[37] Art 16(3) of ESAs Founding Regulations.
[38] *ibid.*
[39] *ibid.*
[40] Art 16(4) of ESAs Founding Regulations.
[41] M. Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework', (2007) 13 *European Law Journal* 4, 452.

techniques, despite their informal nature, serve as enforcement tools likely to carry more weight as they come with real reputational costs and consequences. What is more, the strength of the Authorities' guidelines and recommendations is likely to be reinforced by the fact that these powers are exercised in the shadow of Authorities' formal decision-making powers. *Vis-à-vis* the same national competent authorities and individual financial institutions, the ESAs can adopt, as mentioned earlier, binding decisions.

The ESAs, thus, exercise both types of powers that Eduardo Chiti identified in his previous contribution in this special issue as summarising the contribution of European agencies to administrative rule-making: *participation in the adoption of implementing rules* (in this case, through the adoption of regulatory and implementing technical standards) and *regulation by soft law* (through the adoption of guidelines and recommendations). What sets these agencies apart within the broader agency population however is, as the analysis above clearly indicated, that these powers, be in the form of technical standards or soft law powers such as guidelines and recommendations, although not binding, are anything but negligible and represent a culmination of agency contribution to rule-making. The Authorities' guidelines and recommendations come with an obligation of compliance reporting on the part of competent authorities or financial institutions, justification/explanation of non-compliance and enforcement tools such as the threat of public disclosure in cases of non-compliance on the part of competent authorities. They are, thus, likely to condition and have a real impact on the behaviour of competent authorities and financial institutions. Moreover, their draft technical standards have the potential to significantly limit the Commission in its exercise of delegated powers. This only serves to highlight the relevance of the Authorities' (role in) non-legislative rule-making.

Given the significance of these powers, the procedural framework of both types of powers—the adoption of draft technical standards and the so-called regulation by soft law—is made subject to requirements of consultation, cost–benefit analysis and transparency. With regard to consultation, however, with respect to ESA's guidelines and recommendations, such consultations are left to the latitude of ESAs and are to be conducted 'where appropriate'. The difference seems to be due to the different procedural outcome; that is, whereas the former result in the adoption of binding rules, the latter amount to the adoption of guidelines and recommendation. However, given the 'strong' nature of these guidelines and recommendations as outlined above, one could question whether such a differentiation is indeed warranted.

The really 'sticky issues', however, in respect of the ESAs rule-making arise primarily from their institutional and governance structures, and the manner in which they could impact agency rule-making. It is to these issues that we now turn.

IV A Predicament: A Rule-Making Design Fraught with Conflicts and Tensions

A close analysis of the rule-making design and the role of various actors involved in the adoption of technical standards reveals difficulties that could materialise at two different levels, negatively impacting on the Authorities' rule-making: (1) internally at the level of its board of supervisors, and (2) externally in the interaction and work division between the Authority and the European Commission.

A Internal Challenges: Conflicts of Interests and the Credibility of Rule-Making

At the ESA level, draft technical standards, as well as guidelines and recommendations, are adopted by a board of supervisors, each Authority's primary decision-making and rule-making body. Each Authority also has a management board, which is focused on performance and budgetary steering and oversight. The board of supervisors adopts the draft technical standards and guidelines and recommendations by qualified majority.[42] The founding regulations proclaim in no uncertain terms the independence of the board of supervisors: 'The Chairperson and the voting members of the Board of Supervisors shall act independently and objectively *in the sole interest of the Union and shall neither seek nor take instructions from Union institutions or bodies, from any government of a Member State or from any other public or private body*'.[43]

This reflects the fact that the ESA model, more than that of other European agencies before them, is premised upon 'independence', with numerous and largely similar recurring references in specific articles to 'independence' and 'acting in the Union interest alone' or 'in the sole interest of the Union'.[44] Beyond formal proclamations of independence, however, this premise was not completely seen through in terms of the actual structures in place. The ESAs' alleged 'accentuation of their autonomy'[45] is not entirely convincing as national regulatory authorities have a strong position through their presence in the board of supervisors. The board is largely composed of the heads of national supervisory authorities, that is the head of the competent national supervisory authority of each Member State and several non-voting representatives: the chairperson, one representative of the Commission, one of the European Systemic Risk Board (ESRB) and two of the other two ESAs, and in the case of the EBA also one representative of the European Central Bank (ECB).[46] We are familiar with this set-up from the management boards of most European agencies, which are largely composed of Member State representatives, reflecting the central role reserved for the Member States within agency structures. While co-opting the Member States, the model is problematic in terms of possible risks for paralysis and conflict. It creates the potential for tremendous conflicts of interests in the Authorities' main decision-making and rule-making bodies.

Experience with the management boards of earlier agencies demonstrates that this is a serious concern. Conflicts of interests in the boards of agencies are well documented.[47] *De facto*, research reveals that management board representatives tend to be preoccupied with aspects of agencies' functioning directly impacting on national interests, and boards are often fraught with strong conflicts of interests.[48] Whereas these bureaucrats formally fulfil 'double-hated' roles (ie national and

[42] Art 44(1) of ESAs Founding Regulations.
[43] Art 42 of ESAs Founding Regulations.
[44] Art 1, regarding the Authority; Art 42, regarding the chairperson and voting members of the board of supervisors; Art 46, regarding the management board of ESAs Founding Regulations.
[45] E. Chiti (2009), *op cit*, 1431.
[46] Art 40(1) of ESAs Founding Regulations.
[47] M. Busuioc, *The Accountability of European Agencies: Legal Provisions and Ongoing Practices* (Eburon, 2010); M. Groenleer, *The Autonomy of European Union Agencies: A Comparative Study of Institutional Development* (Eburon, 2010); M. Busuioc, 'European agencies and their boards: promises and pitfalls of accountability beyond design', (2012) 19 *Journal of European Public Policy* 5, 719–736.
[48] M. Busuioc (2011), *op cit*.

European), in terms of actual administrative behaviour, board members often seem to remain 'national-minded bureaucrats'. Boards largely composed of heads of national agencies act as communities of like-minded bureaucrats, entrenched in national positions. These positions become reinforced at the EU level, which can serve as a platform for mobilisation around narrowly-drawn national interests rather than bolstering the adoption of supranational norms.[49] Strategically set-up to serve and protect national interests as the Member States' compromise condition to agency creation,[50] post-delegation, board delegations' behaviour often reflects and follows from this logic.

In the case of the Authorities' board of supervisors, risks of interference are bolstered by the fact that the Authorities are partially funded by obligatory contributions from the competent national supervisory authorities.[51] This problematic nature of the set-up is further exacerbated than in the case of the management boards by the fact that unlike a management board, the board of supervisors is the main decision-making and rule-making body. It is these very board members who are to vote and adopt guidelines and recommendations that will be addressed to the authorities they head, or financial institutions within their Member State. As such, conflicts of interests run the risk of permeating the very substance of the Authorities' work. Groups of national supervisors could thwart agency rule-making. Who safeguards and polices that members of the board of supervisors act *in the sole interest of the Union rather than act as vessels for a variety of national interests?* The rule-making set-up is strongly at odds with their independent mandate, and the founding regulations contain no guarantees to safeguard the independence of rule-making and to police conflicts of interests. There are no provisions in place to ensure that the heads of national supervisory authorities do indeed act in the sole interest of the Union, specifying what procedures are to be followed in this regard and what measures are to be undertaken if national rather than Union interests are being acted upon.

The regulatory design, thus, risks jeopardising the credibility and legitimacy of Authorities' regulatory output. The balance of power is clearly tilted towards competent national authorities, with Member States having agreed to more centralisation at the price of safeguarding a strong position of influence for themselves in both rule-making and supervision. As a side note, the risks are, in fact, only more prevalent in respect of the Authorities' supervisory (rather than rule-making) responsibilities, given that it will be the heads of national authorities in the board of supervisors that are to take decisions addressed to their authorities or even take decisions to overrule their national authorities. The risks of conflicting national interests permeating Authorities' supervisory mandates are further highlighted given past experience with previous European institutional arrangements for supervision, which proved to be inefficient to a large extent, precisely because of protectionist tendencies displayed by national supervisors.[52] Questions have already surfaced in practice as to the Authorities' independence, as well as to the behaviour of the national

[49] M. Busuioc (2011), *op cit*. See also S. Suvarierol, M. Busuioc and M. Groenleer, 'Working for Europe? Socialization in the European Commission and Agencies of the European Union', (forthcoming) *Public Administration*.

[50] D. Kelemen, 'The Politics of "Eurocratic" Structure and the New European Agencies', (2002) 25 *West European Politics* 4, 93–118.

[51] Art 62(1) of ESAs Founding Regulations.

[52] L. Dragomir, *European Prudential Banking Regulation and Supervision: The Legal Dimension* (Routledge, 2010), at 269–298.

authorities they are overly dependent on, with respect to the supervisory side of their responsibilities.[53]

B External Challenge: The Interaction with the Commission

At the next level in the adoption of draft technical standards,[54] lurks another risk in terms of the interaction between the Authority and the European Commission. As observed above, a level of ambiguity and potential for tensions is incorporated in the rule-making design. While the Authorities' rule-making is subject to Meroni limitations, and draft standards need to be adopted by the Commission, at the same time the Commission is discouraged to depart from the draft of the Authority, and stricter controls can come into place in this case—that is, a longer period for objecting to the act for the EP and the Council, as well as the possibility of hearings of the responsible commissioner. This type of set-up, by virtue of its ambiguity—on the one hand seemingly strongly discouraging the Commission from departing from the agency draft, while at the same time not granting direct rule-making powers to the agency—does pose two opposing risks, depending on how the relationship with the Commission will develop in practice.

a) An Overbearing Commission

Institutionally, the Commission could stand to lose out *vis-à-vis* the Authorities in terms of its control over delegated rule-making and the rule-making agenda. The Commission clearly resents the extensive controls placed on its power to adopt delegated and implemented acts, as illustrated by its recurring objections inserted in the text of various proposals for sectoral legislation.[55] Keen to maintain a hold on its institutional prerogatives, the Commission could perceive the Authorities as a threat and rival to its rule-making powers, and decide to assert control by trying to sideline them. Ultimately, despite the restrictions in place on its room for manoeuvre, the Commission decides whether it will amend, reject or endorse a standard. There is a possibility for the Commission choosing to assert itself, and there are some precedents pointing in this direction: reportedly, the Commission was heavily redrafting one of the Authorities' predecessors'—the Committee of European Securities Regulators—initial advice on level 2 measures.[56] The position of the Commission *vis-à-vis* the Authorities could also be strengthened by the fact that the Commission is present in both the management board and the board of supervisors, albeit without voting rights, and has a right of vote over the Authorities' budget.[57]

Such an approach would run the risk of rendering the Authorities irrelevant, calling into question the legitimacy of rule-making in this area and also the credibility of ESAs *vis-à-vis* market actors. It would also likely impact the quality of the rules thus adopted and of the rule-making process. The rules adopted while sidelining the Authorities would be deprived of the valuable input stemming from

[53] The criticism referred to the EBA. See BBC News, 'German minister rejects plans to pool Eurozone debt', available at http://www.bbc.co.uk/news/business-18438402.

[54] In respect of guidelines and recommendations, this next level is absent, as they are adopted solely by the Authorities without any involvement from the Commission.

[55] See above, n 33.

[56] N. Moloney (2010), *op cit*, 1353.

[57] Art 45(2) of ESAs Founding Regulations.

their specialised expertise, as well as privileged inside knowledge of and closeness to the market. What is more, the draft standards proposed by the Authorities are the result of extensive consultation processes; the adoption of different rules unilaterally by the Commission would effectively bypass such requirements. Moreover, interested parties might not see the benefits in participating in consultations on the Authorities' drafts if the Commission were to change these rules extensively subsequently or adopt altogether different rules.[58] Additionally, institutional tensions and in-fighting between the Commission and the Authorities would run the risk of rendering the rule-making process slow and ineffective, jeopardising the efficiency of rule-making.

The Authorities will, thus, have to strike a fine balance between maintaining their independence from the Commission and not altogether completely alienating the Commission. We saw this play out in practice in the case of the European Food Safety Authority (EFSA)—another European agency also created after a crisis, ie BSE (bovine spongiform encephalopathy) crisis—and the earlier example of an agency whose 'independence' was also very much emphasised. In the early days, EFSA reportedly challenged the Commission, displaying a forceful emphasis on its independence, alienating the Commission.[59] The latter started not endorsing its opinions. This affected the legitimacy of the agency, giving a blow to its reputation as a credible regulator. Similarly, if the Commission would repeatedly reject the standards proposed by the Authorities, this could give a serious blow to their legitimacy and credibility as regulators, as well as minimise their contribution to rule-making.

b) Agencies as De Facto *Rule-Makers*

The other risk is that the balance tips the other way. Given the 'technical nature of these acts', the 'highly specialised expertise of supervisory authorities',[60] the risk is that the Commission would not be in a position to second-guess the decisions of experienced supervisors, who are close to the market and would simply rubber-stamp the Authorities' standards. There are considerable informational asymmetries running in the Authorities' favour, which could translate in practice into them becoming the *de facto* rule-makers. Such a scenario would bring back Meroni objections particularly in terms of impact on the institutional balance of powers, and amount to a 'form-over-substance mockery of the legal restriction on delegation of discretionary powers to agencies'.[61]

At the same time, a *de facto* abdication of the Commission on its powers in favour of the Authorities would conceal the real rule-maker. It would come with clear risks at the expense of legal certainty, transparency, negatively impacts the rights of affected parties, and would also raise significant issues of control of delegated and implementing powers. It would breed ambiguity and obscure the real locus of responsibility.

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[58] N. Moloney (2010), *op cit*, 1354.

[59] M. Groenleer (2009), *op cit*.

[60] European Central Bank, 'Opinion of the European Central Bank of 4 May 2011 on a proposal for a directive of the European Parliament and of the Council amending Dir 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority', CON/2011/42, OJ C 159/10, 28.5.2011.

[61] E. Ferran (2011), *op cit*, 46.

The ambivalence and inherent tensions built into the governance structures and rule-making design are problematic. The balance to be struck is a very fine one to ensure the credibility of regulation, and 'high-jacking' of the process by either of the two actors at the detriment of the other could call it into question.

V The ESAs and Rule-Making: A Fine Balancing Act

In terms of their impact on the regulation of financial markets, the new authorities have been heralded as 'a fundamental moment for the evolution of financial regulation in Europe',[62] with expectations that 'over time their cumulative effect [of the changes introduced] could be paradigm-shifting'.[63] Despite Meroni limitations on their rule-making, the ESAs' powers to adopt draft technical standards and their soft law powers are anything but negligible. The former significantly limit the power of the Commission to initiate and adopt implemented and delegated acts, as well as to shape the rule-making agenda. The latter are also strong in character as, despite their non-binding character, they are likely to constrain the behaviour of competent authorities and financial actors. The basic outline of these rule-making procedures is formalised, with the various procedural steps laid out in the establishing regulations, and is made subject to procedural requirements of consultation, as well as cost–benefit analysis and transparency.

But the rule-making design, ambivalent through assigning a strong role to agencies by discouraging the Commission from departing from the agency draft but nevertheless ultimately requiring Commission endorsement to acquire binding force, is problematic. Fraught with conflicts and inbuilt tensions, it could prove a real liability, potentially impacting the legitimacy and credibility of ESAs contribution to rule-making, the quality of the rules adopted, as well as the efficiency of the rule-making process. The Authorities will face a fine balancing act between maintaining the independence of their rule-making from the Commission, while not altogether alienating the latter. At the same time, the relationship with the national authorities is also not unproblematic. Authorities' rule-making is in the hands of the heads of national authorities yet who are to 'act in the interest of the Union alone'. They draft regulatory and implementing technical standards, and adopt guidelines and recommendations, addressed to the authorities they head or to financial institutions in their Members States. However, no provisions are made in the establishing regulations to safeguard ESAs rule-making (or supervision) from conflicts of interests, to police such conflicts so as to protect the independence of their rule-making.

Whether these agencies will be able to live up to the big expectations placed on them and become true authorities in their respective fields remains to be seen. Powerful agencies on paper do not necessarily become equally strong regulators when formal mandates are translated into actual practice.[64] The jury is still out on the extent

[62] Commissioner Barnier, 'Statement of the European Commission following the final agreement on financial supervision reform', Memo/10/436, 22 September 2010, available at http://europa.eu/rapid/press-release_MEMO-10-436_en.htm?locale=en.

[63] E. Ferran, *op cit*, at 41.

[64] See M. Groenleer (2009), *op cit*, on institutional development and discrepancies between formal and *de facto* autonomy.

to which they will be able to grasp and wield *de facto* the powers granted to them by formal design. Much of their credibility and legitimacy and that of their rule-making will depend on how they manage their relations with national authorities and the Commission, and the various inbuilt tensions and governance constraints that are part and parcel of their rule-making framework and governance structures.

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