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The ESA Guidelines: Soft Law and Subjectivity in the European Financial Market—Capturing the Administrative Influence

JAKOB SCHEMMEL*

ABSTRACT

The disastrous performance of European financial-market regulation during the 2008 financial crisis convinced the European powers-that-be of the urgent need for further integration. Since then the European Union (EU) has established three European Supervisory Authorities (ESAs), which are commissioned to enhance capacity and harmonization of the European banking, insurance, and capital markets law. In carrying out this task, the ESAs employ so-called ESA Guidelines, which have caught the attention of practitioners and scholars alike. As soft law, they bear a strong resemblance to instruments used on the global level to regulate the financial markets and therefore might fall prey to the same deficiencies. The ostensible resemblance, however, proves misleading. This Article argues that the deep legal embedding of the ESA Guidelines provides them with a different regulatory profile that leads to a strong enforcement effect (Part II.A), the danger of preponderant industry influence (Part II.B), and the specific characteristics of non-binding rules (Part III). Under the lens of regulatory subjectivity, these features may lead to inefficiency and reduced accountability (Part IV). To mitigate this negative impact, the Article proposes three modest reforms to the legal structure of the ESAs (Part V).

INTRODUCTION

The 2008 financial crisis caught the European Union off guard. The financial crisis

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law of European financial markets was supposed to settle after the wide-ranging changes that had been implemented in the realization of the 1999 Financial Services Action Plan (FSAP). The tumultuous developments of 2008 invalidated that timetable. What followed the largest regulatory flood the financial markets had ever encountered was not a phase of ease, but an even bigger wave of regulation.

All important financial regulations have been either updated or completely overhauled. Along with this reform of the substantive law, the European Union gave itself a new administrative structure to enhance its regulatory and coordinating capabilities: the European System of Financial Supervision (ESFS), which split European supervision into a macro- and a microeconomic column. The institutions established by the ESFS play an important part in spelling out the newly reformed substantive framework of the European financial markets, which is, though already in force, still in large parts a work in progress. The so-called Lamfalussy process is still hammering out specific implementation of the established requirements. At the heart of this procedure, the European Supervisory Authorities (ESAs), established by a series of regulations (ESA Regulations), work tirelessly at defining and harmonizing the legal shape of the European financial system.


3. The ESFS has been constructed according to the so called De Larosière Report, which was mandated by the European Commission to assess the key weaknesses of the European regulatory system that had been uncovered by the financial crisis. See The High-Level Group on Financial Supervision in the EU: Chaired by Jacques de Larosière, (Feb. 25, 2009), available at http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf.

4. For a short overview of the Lamfalussy procedure, see infra Part I.B.2.

financial markets. The ESAs are three nearly identical sister agencies that have been tasked with the microeconomic supervision and regulatory harmonization of the financial markets: the European Banking Agency (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities Market Authority (ESMA). Each of them has been assigned a specific sector: banking, insurance, and securities, respectively. Their organizational structure has been constructed out of the most integrated parts that are currently available in the diverse landscape of European agencies. Even though they are considered network agencies, all three have extensive administrative substructures that are supposed to grow steadily in the next years. This is supposed to enable the ESAs to monitor and facilitate the coherence of financial regulation, whereas the routine of daily supervision is mostly left to the national supervisors.

The European agencies are equipped with a truly impressive supervisory and regulatory toolkit. When designing it, the European legislature did not only think of traditional legal means; it also upgraded and expanded traditional soft-law instruments. The result has caught the attention of practitioners and scholars alike.

Soft guidance in the form of the ESA Guidelines has been implemented as one of the central tools in the regulation of the European financial markets. Three and a half years after their establishment, the ESAs had already published forty-three guidelines. According to the ESAs annual work programs, over sixty specific guidelines were published from 2014 through early 2015 alone: seven by the EBA, thirty-six by the EIOPA, and twenty-one by the ESMA. It therefore seems as though soft guidance will be an essential part of the future of European financial regulation.

Soft law is hardly new in the sphere of financial regulation.

6. EBA Regulation, supra note 5, at 17 (Recital 39); ESMA Regulation, supra note 5, at 89 (Recital 39). "Network agencies" are administrative structures of the European Union that are governed by a network of Member State authorities, i.e. the 28 heads of the respective national authorities. Most of them do not possess extensive administrative substructures but are mere coordinative entities. Network agencies are tasked with legislative coordination. For an instructive introduction, see David Coen & Mark Thatcher, Network Governance and Multi-level Delegation: European Networks of Regulatory Agencies, 28 J. PUB. POL’Y 48 (2008).

7. An important exception is the supervision of credit rating agencies, assigned to the ESMA. See Council Regulation No. 1060/2009, 2009 O.J. (L 302) 1 (EC).


9. I will not dwell on the question of whether soft law can be called "law" or what actually constitutes soft law. Instead I will use the term simply to describe agreements that neither purport to have nor actually have directly legally binding effects. For further
Especially on the global level, soft governance is the most dominant means of coordinating financial markets. The implications and deficiencies of such nonbinding harmonization, and especially its most prominent example, the Basel Committee's publications, have been widely discussed. It often has been noted that they entail compliance and legitimacy problems. With that in mind it seems reasonable to expect that the ESA Guidelines might suffer from the same defects. Indeed, the structure and mechanisms of the Basel Committee and the ESAs seem surprisingly similar at first glance. However, the deep legal and political embedding of the ESAs in the European Union, as well as the procedural provisions of the Guidelines, severely reduce the likelihood of noncompliance by the Member States. By contrast, a hard look shows that legitimacy problems seem to exist also on the European level. The soft-law nature of the Guidelines leads to reduced accountability when compared to legislation. This might enable special interests to influence their drafting.

Against this background the question arises of why the European legislature decided to draft the ESA Guidelines as soft guidance. Though European law generally restricts the legislative powers that can be assigned to an agency, there are procedural circumvention techniques that already enable the ESA to act as a de facto legislator. However, flexibility, swiftness, and a special regulatory effect caused by the combination of soft law and the underlying hard law tilted the balance toward an additional soft-law instrument.

From a subjectivity perspective, certain normative conclusions can be drawn. Subjectivity as substantive programming of legal entities implies a more intrusive approach to regulation. It aims at creating a certain organizational fabric of the regulatory target by defining its inner structure. It thereby seeks to predetermine acts of the regulated


10. See infra I.A.

11. One of the most significant shared characteristics of the two is that the heads of the national financial regulators are the key players in both institutions. Therefore, from a political science perspective, they both qualify as transgovernmental networks (TRN). See generally Burkard Eberlein & Abraham L. Newman, Escaping the International Governance Dilemma? Incorporated Transgovernmental Networks in the European Union, 21 GOVERNANCE: INT'L J. POL'Y, ADM. & INST. 25 (2008) (discussing transgovernmental networks and European Union policymaking).

12. See infra I.B.

13. See infra I.C.

14. See infra II.A.
entity, rendering traditional instruments of regulation redundant. If ESA Guidelines are used as an instrument to shape subjectivities, their "hardened" soft-law nature reinforces calls for an administrative law that acknowledges and reflects their wide-ranging effects.15

I. ESA GUIDELINES AS SOFT LAW

According to Article 16 of the ESA Regulations, ESA Guidelines should work toward "establishing consistent, efficient and effective supervisory practices within the ESFS, and ... ensuring the common, uniform and consistent application of Union law." They can be addressed to Member State supervisory authorities and financial institutions, but until now almost all of the Guidelines have been addressed to the supervisory authorities to establish a common understanding of European law. The ESAs can issue guidelines with respect to all relevant matters within their scope of action. Even though some European acts expressly require the ESAs to issue guidelines for further elaboration of a certain requirement, the authorities are not limited to these explicit authorizations. On the contrary, the ESAs are entitled to publish guidelines on their own initiative and on almost every topic that seems relevant. The ESA Regulations, however, do not provide for legally binding guidelines.16 This means they do not create any legal rights or duties.17 Since Article 263 of the Treaty on the Functioning of the European Union (TFEU) states that the Court of Justice of the European Union (CJEU) only reviews acts "intended to produce legal effects," ESA Guidelines cannot be subject to judicial review by the European courts.

15. See infra III.

16. Some confusion resulted from the wording of the ESA Regulations. They do not expressly state that ESA-Guidelines are mere soft-law instruments. A corresponding reference had been removed in the legislative process by the European Parliament. This has led to a certain sense of "ambiguity" among scholars when it comes to the legal nature of the ESA-Guidelines. See Rob van Gestel & Thomas van Golen, Enforcement by the New European Supervisory Agencies: Quis Custodiet Ipsos Custodes?, in VARIETIES OF EUROPEAN ECONOMIC LAW AND REGULATION: LIBER AMICORUM FOR HANS MICKLITZ 757, 766-67 (Kai Purnhagen & Peter Rott eds., 2014). However, even without considering the restrictive European law of agency powers, see infra II.A, the structure and procedure of the Guidelines as laid down in the ESA Regulations clearly suggest that they are legally nonbinding tools. This is also the most common interpretation among European legal scholars. See Madalina Busuioc, Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope, 19 EUR. L.J. 111, 118 (2013); Marloes van Rijsbergen, On the Enforceability of EU Agencies' Soft Law at the National Level: The Case of the European Securities and Markets Authority, UTRECHT L. REV., Dec. 2014, at 116.

17. At least no direct legal effects. For a discussion of the possible indirect legal effects, see infra note 194.
Soft governance is an old phenomenon that has been discussed extensively. One of the oldest traditions of using soft law as a means of coordination can be found in international law. Therefore, a first reference point for assessing the functional design of the ESA Guidelines can be gained by taking into account the literature discussing international soft law of the global financial markets. The most prominent examples in this regard are the publications on bank capital and liquidity of the Basel Committee on Banking Supervision. Like the ESAs, the Basel Committee is run by the heads of national supervisory authorities. It therefore seems probable that the key deficiencies of global financial-market soft law might also apply to ESA Guidelines (Section A), namely noncompliance (Section B) and preponderant industry influence (Section C).

A. Global Soft Law: The Basel Committee

The literature on international soft law is extensive and correspondingly rich. In international law, “soft agreements” are often used as a “stepping stone” to reach consensus in areas in which a “hard” treaty arrangement cannot be achieved. A nonbinding agreement does

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not only allow for a flexible and fast solution\textsuperscript{20} but also for more detailed and precise provisions when compared to a treaty, because it can be met by a low level of compliance.\textsuperscript{21} Negotiation and exit costs are therefore comparatively lower than in treaty formation.\textsuperscript{22} This characteristic of a provisional commitment has, however, also been identified as one of international soft law's key weaknesses: nations are able to and engage in "cherry-picking" of soft law provisions or abandon prior commitments entirely,\textsuperscript{23} even though heavy political pressure on the global level can lead to high compliance rates.

When it comes to the international regulation of financial markets, sheer political power is not always necessary. There are additional supporting mechanisms at work that further compliance: expertise and market pressure.\textsuperscript{24} These are the main driving forces behind the overall high compliance with private standards, which are especially dominant in international financial law. Private standards have a substrate of expert knowledge.\textsuperscript{25} They draw legitimacy and compliance from this expertise. Furthermore, the need for uniform rules often leads to indirect enforcement by third parties.\textsuperscript{26} Some of the private standards are even "upgraded" to public rules by lawmakers.\textsuperscript{27} Even though such an "upgrade" might be the most blatant case, private standards in general create an friction with legitimacy considerations.\textsuperscript{28} Put briefly,
“Standard setters are accused of being secretive, industry dominated, and unrepresentative of all interested parties.”

Most of the above holds true in regard to the Basel Committee. The Basel Committee on Banking Supervision is a forum for regular cooperation on banking supervisory matters, which is institutionally assigned to the Bank for International Settlements (BIS). The Committee has twenty-eight member nations that are represented by their central banks and financial supervisors. Lacking a legal mandate, all of its publications are mere soft law. In contrast to a European directive or an international treaty, states that commit to the Basel Committee’s standards have no legal obligation to transpose them into national law. They still might yield to different considerations, as the example of the long-delayed implementation of Basel II by the United States richly illustrates. Even though the last financial crisis led to a political environment that favors strict and internationally coordinated financial regulation, incentives for noncompliance remain especially powerful in financial markets regulation. To counter these, the Financial Stability Board (FSB) has put in place peer-review mechanisms that are supposed to increase political pressure. Furthermore, concerns about the Basel Committee’s legitimacy have been voiced. The Committee has been described as secretive in its

32. Barr, supra note 30, at 995 et seq.
deliberations\textsuperscript{35} and industry-friendly in its regulatory approach.\textsuperscript{36} In response to such criticism, the Basel Committee has resorted to a public notice-and-comment procedure.\textsuperscript{37} Still, legitimacy concerns persist.

When considered against this background, it seems reasonable to expect that the ESA Guidelines as soft law might also fall prey to these two main deficiencies: on the one hand, they might suffer from underenforcement or noncompliance, since certain regulatory projects might have been downgraded to the ESA-level to reduce compliance costs. On the other hand, the involvement of stakeholders and private interest groups might raise legitimacy issues that could undermine the neutral expert standing of the ESAs.

**B. The Danger of Noncompliance**

The ESA Guidelines are legally nonbinding. However, the lack of legal effect does not equal irrelevance. As the ESA Regulations state, "The competent authorities and financial institutions shall make every effort to comply with those Guidelines and recommendations."\textsuperscript{38} Though this statement might give rise to a political duty without legal repercussions, it is in fact observed: only a few instances of noncompliance have been reported by Member State authorities.\textsuperscript{39} The "factual relevance" that has been assigned to the Guidelines by scholars does exist. Its roots can be traced to the ESA Regulations (Subsection 1), and its reach extends to market participants (Subsection 2). In the multilayered governance system of the EU, the ESA Guidelines naturally affect two levels. On the European supervisory level, it determines the practices of the national supervisory authorities, which, on the national level, impose the Guidelines on financial institutions that have no recourse but to comply or sue.

\textsuperscript{35} David Zaring, *Informal Procedure, Hard and Soft, in International Administration*, 5 CHI. J. INT'L L. 547, 569-72; see also Brummer, supra note 31, at 61; Mitchel & Farnik, *supra* note 30, at 244.

\textsuperscript{36} See Alexander, *supra* note 30, at 879-80.

\textsuperscript{37} See Michael S. Barr & Geoffrey P. Miller, *Global Administrative Law: The View from Basel*, 17 EUR. J. INT'L L. 15, 16 (2006); see also Lyngen, *supra* note 33, at 532 (criticizing the legitimacy since the actual negotiations among the Committee members are still held in secret).

\textsuperscript{38} EBA Regulation, *supra* note 5, at art. 16, ¶ 3.

\textsuperscript{39} Instances of noncompliance have, for example, arisen in the context of Solvency II, see infra note 110 and 147. France was not prepared to apply certain requirements beforehand. Even in this regard, however, there were only 15 noncompliance notes, compared to 790 compliance reports. See Guidelines on Complaints-Handling by Insurance Undertakings, EUR. INS. & OCCUPATIONAL PENSIONS AUTHORITY (Mar. 21, 2013), https://eiopa.europa.eu/publications/eiopa-guidelines/guidelines-on-complaints-handling-by-insurance-undertakings.
1. National Supervisors: "Comply or Explain" and "Name and Shame"

On the European level ESA Guidelines in most cases address Member State authorities. To ensure Member State compliance, the ESA Regulations establish certain soft enforcement tools that until now have worked efficiently.

The high compliance level is mainly fostered by the determined political commitment of the relevant actors to the goal of a harmonized financial-markets law. This constitutes a significant departure from the political status quo before 2008. The predecessors of the ESAs also published guidelines and were supposed to establish a harmonizing coordination between the Member State authorities. However, it was clearly recognizable to the European Commission that, "at times, the Level 3 Committees do not seem to be fully equipped to deliver what has been expected of them [and that a] stronger political impetus [was] needed." The financial crisis gave rise to such a political impetus: one of the main aims in establishing the ESFS was the "[g]reater harmonisation and the coherent application of rules for financial institutions and markets across the Union." The financial turmoil of 2008 led to a general political consensus that a single rulebook for the European financial markets had to be established. That consensus is still shared among supervisors and politicians. In this regard, both the ESA framework and the Basel Committee profit from the strong political agenda fueled by the financial crisis that has set a fast pace for regulatory reform for the last few years.

That strong political impetus is also reflected by the ESA Regulations. They establish that "[t]he competent authorities and financial market participants shall make every effort to comply with [the] guidelines and recommendations." This provision has caused quite a headache among scholars. Whereas the noncompliance option for national authorities clearly shows that the provision cannot embody

40. Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and Committee of European Securities Regulators (CESR).
42. EBA Regulation, supra note 5, at 13 (Recital 9).
43. For the strong political pressure on the Basel Committee from the G20 countries, see Eernisse, supra note 30, at 253.
44. ESMA Regulation, supra note 5, at art. 16, ¶ 3.
a legal obligation, its wording suggests at least some kind of legal relevance. However, the comply-or-explain mechanism is the only instrument of enforcement, which renders the wording a political postulation.

It therefore comes as no surprise that “comply or explain” dominates the literature on the ESA Guidelines. The procedure has a straightforward design. Once approved by the ESAs' governing body, the Board of Supervisors, guidelines are published on the websites of the ESAs. Within the next two months, each Member State has to declare itself either compliant or noncompliant, meaning that it intends or does not intend to apply the Guidelines when supervising market participants. If a Member State does not intend to comply, it has to explain its noncompliance to the European authority. The noncompliance is published by the ESAs. If it deems it necessary, each ESA can additionally publish the explanation given by the Member State for its noncompliance. The ESA is able to “name and shame” the deviator. Furthermore, the ESAs are supposed to monitor the implementation of the Guidelines by peer review.

A substantial “hardening” of the Guidelines' soft law has been attributed to this procedure. The mandatory publication of noncompliance in particular is described as one of the core features that will significantly increase Guideline application. This practice of “naming and shaming” is said to reduce noncompliance to a minimum.

46. See id.

47. In accordance with article 73 paragraph 1 of the ESA Regulations, all guidelines are translated into all official EU languages. EBA Regulation, supra note 5, at 45; EIOPA Regulation, supra note 5, at 81; ESMA Regulation, supra note 5, at 117.

48. EBA Regulation, supra note 5, at art. 16, ¶ 3.

49. Financial institutions do not have to report their compliance status unless the Guidelines require it. In this case, no explanation is required and the noncompliance of the market participant is not published. However, its compliance is ensured by the interpretation and enforcement powers of the supervisory authorities. See infra I.B.2.

50. Even though the wording of the ESA Regulation does not explicitly provide for them, cases in which a guideline is not applied by a Member State despite a previously submitted notice of compliance should also be published in order to give full effect to the reputational enforcement mechanism.

51. EBA Regulation, supra note 5, at art. 30, ¶ 2(b); EIOPA Regulation, supra note 5, at art. 30, ¶ 2(b); ESMA Regulation, supra note 5, at art. 30 ¶ 2(b).

by threatening the reputation of a Member State.\textsuperscript{53} Indeed, Member State supervisors will now have to engage in an examination of the ESA Guidelines. Furthermore, the explanation requirement leads to a certain degree of reasoned decision-making, as insufficient explanations run the risk of being published along with the noncompliance notice and might turn into an embarrassment or an undesired market signal that undermines a supervisor's reputation.

Whether this really cures the European soft law of potential compliance issues is unclear. After all, reputational mechanisms also exist on the global level. The FSB has put in place peer-review mechanisms as well.\textsuperscript{54} Still, there are substantial differences between the procedures that are likely to result in different compliance rates. Those differences are rooted in the completely divergent regulatory settings. Whereas the ESAs operate in a common legislative framework that is aimed at ensuring consistent and coherent legal requirements, the FSB has to deal with diverse jurisdictions, which are not governed by mutual financial regulations. At the European level, Member States have already relinquished their respective sovereign powers to the European Union by the time the ESAs come into play. By contrast, nation-states are still vigilantly guarding their sovereignty at the global level. Furthermore, the FSB cannot rely on a mechanism comparable to the ESA-Guideline procedure, which is specifically aimed at compliance with one particular soft-law instrument. The Guideline procedure enables the ESAs to exert reputational pressure in a targeted and constructive manner. Noncompliance will be made public, making it easy to understand and designate deviation. Again by contrast, the FSB mostly conducts country and thematic peer reviews\textsuperscript{55} that are not structured as clearly as ESA compliance reports. They therefore run the risk of burying important details in technocratic reports that are not as easy to access as the color-coded compliance tables of the ESAs. This is likely to reduce the overall reputational pressure. Another problem that has been identified in the FSB peer-review system is that it lacks sufficient funding.\textsuperscript{56} However, the most striking difference between the

\textsuperscript{53} See Busuioc, supra note 16, at 118–19; see also van Gestel & van Golen, supra note 16, at 766; Wymeersch, supra note 52, ¶ 9.167.

\textsuperscript{54} See supra text accompanying note 34.

\textsuperscript{55} Of the 20 peer reviews conducted by the FSB, so far 12 have been country reports and 8 thematic peer reviews. Peer Review Reports, FIN. STABILITY BOARD (2016), http://www.fsb.org/publications/peer-review-reports/?mt_page=1.

\textsuperscript{56} See Eric Helleiner, What Role for the New Financial Stability Board? The Politics of International Standards After the Crisis, 1 GLOBAL POL'Y 282, 286 (2010); see also Eric Helleiner, Debate: Did the Financial Crisis Generate a Fourth Pillar of Global Economic Architecture?, 19 SWISS POL. SCI. REV. 558, 559 (2013); Jonas Pontusson, Global and
two systems is the consensus requirement of the FSB. As all peer-review reports need to be approved before publication by the FSB Plenary, the FSB’s decision-making body, a country under review that fears reputational damage is in a position to block the release. The publication of a noncompliance notice, however, is mandatory under the ESA Regulations. The FSB peer-review mechanisms, therefore, rather aim at peer pressure among the club of regulators, whereas the ESA procedure can also draw support from the disciplining effects of public shaming and market reputation.

Another reason for the high compliance rate of the ESA Guidelines is the coordinating function of the Board of Supervisors. It is the agencies’ most important governance institution, which makes all important decisions. The Board consists of the heads of all twenty-eight supervisory agencies of the EU Member States and constitutes the core network element of the agencies. Therefore, even though the ESAs are European agencies by their nature, the role that is assigned to the Member State actors is significant. Supported by the permanent staff of the ESAs, the Board of Supervisors issues “implementing technical standards” and “regulatory technical standards” makes binding decisions if EU law is breached, an emergency situation occurs,
or a disagreement among Member States arises, and approves new guidelines. Almost all of these decisions are made by a qualified majority of the board. As the members of the board are the heads of the national supervisory authorities, they know exactly what is politically feasible in their respective Member States. In most cases, it is they who decide whether a Member State will comply with the Guidelines or not. Furthermore, it is likely that the culture of the European Council, which places great value on consensus, will dominate among the chief supervisors. Especially against a political background that continuously stresses the need for a coherent EU law, the pressure to reach a compromise is very high. Therefore, even though a qualified majority is sufficient to adopt a guideline, most decisions will be taken on a consensus basis. The peer pressure among the supervisors is likely to serve as another factor inducing compliance. Board members might fear for their credibility and therefore not deviate from Guidelines once they have been agreed to.

Commentators have attributed a certain coordinating function to the Basel Committee as well. However, due to the heavy regulatory impact of most issues the Basel Committee deals with, implementation is not at the discretion of the respective member representatives. In most instances, the required changes to the national financial markets law require legislative execution and cannot be adopted by central banks or supervisory authorities on their own. By contrast, ESA Guidelines are supposed to only specify already implemented European legal acts. This results in a low level of accountability. Guidelines are issued by the ESAs without a mandate or any control mechanism of the

63. EBA Regulation, supra note 5, at arts. 17–19; EIOPA Regulation, supra note 5, at arts. 17–19; ESMA Regulation, supra note 5, at arts. 17–19.
64. EBA Regulation, supra note 5, at art. 16; EIOPA Regulation, supra note 5, at art. 16; ESMA Regulation, supra note 5, at art. 16.
65. See EBA Regulation, supra note 5, at art. 44; EIOPA Regulation, supra note 5, at art. 44; ESMA Regulation, supra note 5, at art. 44, which cross reference art. 16 paragraph 4 TEU.
67. See Moloney, supra note 52, at 65–66 (mentioning the ESA competencies to issue binding decisions in this regard); see also EBA Regulation, supra note 5, at arts. 17–19; EIOPA Regulation, supra note 5, at arts. 17–19; ESMA Regulation, supra note 5, at arts. 17–19. However, whether these can be used to enforce Guidelines that Member States have not complied with seems disputable. In this case, the binding decision powers of the ESA would make the possibility of noncompliance irrelevant and indirectly give legal effect to the Guidelines. The singular nature of the ESA competencies postcrisis might justify this; mediation and breach of Union law rather not.
68. See Barr, supra note 30, at 982 n.51.
69. See generally Pierre-Hugues Verdier, supra note 31 (discussing the Basel II implementation process in the United States).
European Parliament or Council. Just as the Basel Committee, the ESAs lack the power to make law. However, since ESA Guidelines do not require transposition into national law, but are integrated into the respective jurisdictions through the supervisor's discretion, they lack subsequent legislative approval. Thus, the coordinating function of the ESAs has a greater effect than the one attributable to the Basel Committee.

2. Financial Institutions: Big Stick or Day-to-Day Supervision?

Institutions face different factors that make the Guidelines "quasi-binding" for them. Some scholars suggest that peer pressure among financial institutions contributes significantly to the "factual" binding effect, since institutions will fear the "big stick" of a binding legal act and will therefore comply with nonbinding Guidelines to retain at least some room to maneuver. This take on the problem sounds convincing at first but is put under pressure by the collective-action problem. Taking into account the hundreds of financial institutions in more than two dozen jurisdictions that are subject to ESA Guidelines, it is more likely that institutions will engage in opportunistic behavior and free-riding than complying as a group to avoid hard-law regulation.

A more convincing explanation can be given by looking at the interwovenness of the Guidelines with hard law. In contrast to the supervisory authorities, financial institutions face hard enforcement of the soft-law requirements: the enforcement power of the European supervisory authorities can translate nonbinding standards into actual hard law. If considered in isolation from other factors such as judicial enforcement.

70. See Moloney, supra note 52, at 65.
71. van Gestel & van Golen, supra note 16, at 766.
74. Terpan, supra note 9, at 84-85 (noting the difficulty of differentiating soft law from hard law, as soft law is undergoing a specific hardening that is "ambiguous" to its actual soft legal nature). However, Terpan's analysis deals with the enforcement regime of the European Commission in relation to the Member States. By contrast, the ESA-Guidelines are only subject to soft enforcement on the European level, whereas, when applied by the Member States on the national level, they are fed into the hard enforcement of the supervisory authorities.
review, it does not matter how the decision of a supervisory authority is substantively programmed. No matter whether laid down in a European regulation, a Member State transposition act, or a nonbinding interpretative guideline, the substance of an administrative decision is legally binding. Therefore, market participants are generally well advised to comply.

The interrelations at work are best understood against the background of the specific structure that governs EU financial regulation: the Lamfalussy procedure. The Lamfalussy procedure constitutes the four-level regulatory process of the European financial markets, in which regulation is supposed to gain more and more detail with each level it passes through. The division of labor among the different actors is supposed to make regulation faster and more efficient, thereby leading to an optimal allocation of legitimacy and expertise. The underlying rationale of this regulatory system is that important decisions with broad implications are made at the first level, while the details are left to lower levels. At the first level, so-called "framework directives" of the European legislature (i.e., the European Parliament and Council) are supposed to lay down the fundamentals of the legislation. These are further defined by the Commission via delegated and implementing acts at the second level. This second level needs to be activated through a mandate of the European legislature, which controls how finely grained the regulation is designed. At the third level, the ESAs come into play. They are in charge of further refining the second-level interpretations and coordinating the application of European law among the national supervisory authorities. A central tool at this stage is the ESA-Guideline. Finally, at the fourth level, it is the responsibility of both the ESAs and the Commission to monitor the application of the law and ensure coherence.

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75. The procedure is named after the head rapporteur of a "Committee of Wise Men" report that first suggested the procedural changes to the European regulation in the financial markets. In the wake of the FSAP, the Commission had also called for a faster and more efficient procedure to draft, issue, and implement the extensive legislative changes that were supposed to give the European financial markets a more integrated legal form. The procedure designed for the FSAP proved to be so successful that its application was extended from capital markets regulation to banking and insurance regulation as well. For a more detailed overview, see Duncan E. Alford, The Lamfalussy Process and EU Bank Regulation: Another Step on the Road to Pan-European Regulation?, 25 ANNUAL REV. BANKING & FIN. L. 389, 397 et seq. (2006).

76. Id. at 399.

77. Id.

78. It is at this fourth stage that the ESAs are supposed to use peer review to monitor the application of ESA-Guidelines. See supra text accompanying note 51.
The "Guidelines on certain aspects of the MiFID compliance function requirements"\textsuperscript{79} offer a quite descriptive example of the "hardening" effect of the Lamfalussy procedure on ESA Guidelines, and also gives insight into the multilevel governance system of the European Union. In 2004 the European legislature issued the Markets in Financial Instruments Directive (MiFID 1),\textsuperscript{80} a first-level framework directive, which by its legal nature was not directly legally binding on the Member State jurisdictions but had to be transposed into national law.\textsuperscript{81} MiFID 1 stated that Member States should require investment firms to establish adequate policies and procedures sufficient to ensure compliance of the firm.\textsuperscript{82} To further elaborate this requirement, the European legislature also provided a legislative mandate for the Commission to adopt second-level implementing measures. Relying on this mandate the Commission issued an implementing directive, which stated that Member States, to fulfill their obligations under MiFID 1, should require investment firms to establish and maintain a permanent and effective compliance function which should operate independently and should carry out certain tasks, such as monitoring and assessing the adequacy and effectiveness of the measures and procedures put in place to ensure compliance.\textsuperscript{83} The first- and second-level directives and their respective requirements were transposed into binding national law. The United Kingdom, for example, updated its policies to include the legal requirements of the European law, with wording nearly identical to that of the European acts.\textsuperscript{84} In 2008 the Commission noted that the legal transposition of the MiFID and its implementing

\textsuperscript{79} EuR. SEC. & MKTS. AUTH. (ESMA), GUIDELINES ON CERTAIN ASPECTS OF THE MIFID COMPLIANCE FUNCTION REQUIREMENTS, ESMA/2012/388 (Sept. 28, 2012) [hereinafter ESMA-MIFID].

\textsuperscript{80} Council Directive 2004/39, 2004 O.J. (L 145) 1 (EC). The European legislature already published an updated version of this directive, MiFID 2, which will take effect in January 2017. See Council Directive 2014/65, art. 93, para. 1, 2014 O.J. (L 173) 349 (EU). This directive will be complemented by a directly applicable regulation that will recast some of the provisions of the MiFID 1. Together both measures will replace the old MiFID, which will have been in force for over a decade. See Commission Regulation 600/2014, 2014 O.J. (L 173) 84 (EU).

\textsuperscript{81} Article 288, paragraph 3 of the TFEU states, "A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods." Consolidated Version of the Treaty on the Functioning of the European Union art. 288, para. 3, Oct. 26, 2012, 2012 O.J. (C 326) 172.


measures was successfully completed by the United Kingdom.85

However, this was not the final word on European compliance requirements. In 2012 the newly founded ESMA, one of the three ESAs, deemed it necessary to use its powers under Article 16 of the ESA Regulations in order to further ensure the common, uniform, and consistent application of MiFID 1. After ESMA had held an open and public consultation and requested a statement of stakeholder groups, it published the “Guidelines on certain aspects of the MiFID compliance function requirements.” These guidelines laid down precise and specific instructions on how the European directives with regard to the compliance function should be interpreted, covering areas such as group companies, methodologies, information relevance, and complaints.86 The guidelines became effective sixty days after their publication, triggering their only legal effect: the duty to comply or explain.87 As expected, all European supervisory authorities, including the two most important U.K. financial regulators, the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), declared themselves compliant.88 They thereby expressed their intent to apply the nonbinding ESMA-Guidelines when construing the national law that transposed the European directives. Thus, FCA and PRA will take into account the content of the ESMA-Guidelines when assessing what features are required to establish “a permanent and effective compliance function which operates independently” under their own mandates.89 Failure to meet these requirements will carry enforcement actions in accordance with the Decision Procedure and Penalties Manual of the FCA and PRA.90

This example illustrates how our notion of the nonbinding instruments needs to be revised when it comes to the multilevel system of the European Union. The ESA Guidelines might be nonbinding of their own force; however, their embedding in the European regulatory system endows them with significant legal relevance when applied by the Member State authorities. Their content becomes law through the

86. See ESMA-MiFID, supra note 79, at 25–26.
87. See supra Part I.B.1.
89. Section SYSC 6.1.3 of the FCA and PRA Handbooks.
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interpretation of the supervisors. Though decisions by the supervisory authorities are still contestable in the Member State courts, which are not bound by the Guidelines, the change in legal relevance is remarkable. This constitutes the main difference from the soft-law publications of the Basel Committee, which have to be transposed into national law by an ordinary legislative procedure. Due to the third-level status of the ESA Guidelines, they do not require transposition, but can be introduced via the discretionary enforcement power of the national supervisory authorities.91 Their interpretation and enforcement authority turns soft law into hard legal requirements for financial institutions.92

In some cases the Member State supervisors even use lawmaking powers to upgrade an ESA-Guideline. This transposition approach seems to occur in several jurisdictions: ESA Guidelines are republished

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91. See van Rijsbergen, supra note 16, at 120. This is the main mechanism for the de facto legal relevance of the ESA-Guidelines that has until now not received the attention it deserves. Even thorough studies of the ESA-Guidelines' effects and their de facto implications stop with the rules on the books and do not consider the enforcement of the rules. See generally id. at 125–28 (explaining that rules may not be uniformly applied among Member States). It is not surprising that “[e]ven though in general the FCA Handbook is presented as a non-binding integration instrument, it is considered by financial market participants as entailing rules that are binding upon them” if the respective underlying principles are enforced by the authority publishing the Handbook. Id. at 128.

92. This is the major difference between my argument here and the theory of incorporated transgovernmental networks laid down by Eberlein & Newman, supra note 11, at 31 et seq. Whereas Eberlein and Newman stress that independence and formal authority of the Member State authorities are the two major characteristics enabling incorporated transgovernmental networks to operate as efficiently as they do, see id. at 30, the example of the ESAs rather suggests that the deep integration of the authorities into the existing European law is the decisive force responsible for the major impact of their work. Eberlein and Newman found that “insufficient powers constrain the effectiveness of authority-based, domestic enforcement.” Id. at 44. Because of the ESA-Guidelines' status as third-level instruments, such constraint does not hinder enforcement by national authorities. According to incorporated transgovernmental networks theory, national authorities need a delegation of formal regulatory authority to establish an efficient coordination, see id., but in the ESA context this power has already been delegated to the authorities in charge of enforcing the substantive provisions of European financial markets law. The enforcement powers of regulatory agencies are sufficient to establish a coordinated approach. What Eberlein and Newman seem not to account for is that the European actors of global transgovernmental networks and the actors of European incorporated transgovernmental networks for financial markets law are the same. In either position they represent the same national supervisory authorities with the same regulatory capacities. However, the regulatory subjects discussed by the respective networks differ markedly. Whereas broad-brush coherence needs to be achieved at the global level, the European level rather deals with a coherent enforcement of already harmonized rules.
as national (binding) administrative instruments. In these cases the “hardening” of the European soft law reaches its final stage: ESA Guidelines become national hard law.

3. Conclusion: High Compliance Levels are Likely

One can safely assume that the risk of noncompliance with the European Guidelines is not as pressing as it is on the global level. The strong political pressure toward a more uniform and coherent legislative framework in the European Union, the specific position of the ESA Guidelines as third-level measures in the European legislative system, and the reputational mechanism and coordinating function of the ESAs will lead to a high compliance rate of national supervisors. The European legislature has even inserted the compliance pressure into the wording of the ESA Regulations.

At the Member State level, financial institutions will have no choice but to obey guidelines when applied by their own supervisors. Their discretion when applying transposed European financial regulation turns the soft-law Guidelines into hard law. Even though contestation in court is still an option, the shift in legal relevance is remarkable. The European Union seems to have heeded one of the main insights that the financial crisis has brought: not rules on the books, but enforcement sets the tone of efficient regulation.

C. The Danger of Preponderant Industry Interest

The legitimacy question seems to gain in importance with the previous finding: the harder a soft-law instrument becomes, the greater its need for legitimacy. If we look at the ESAs’ structure from an institutional perspective, there seems to be no problem: an independent

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agency governed by high government officials that takes into account stakeholder input and knowledge when regulating via legally nonbinding instruments. All these features indicate a legitimate decision procedure. However, even if we do not apply a strict definition of democratic accountability, which, e.g., dominates the administrative discourse in the German literature,⁹⁵ an empirical examination of the soundly designed features of the ESAs reveals troublesome issues that raise questions regarding their capability as legitimacy safeguards.

1. Possible Institutional Pathways of Special Interest

Ironically one of the features that has been identified as the major pathway of unbalanced industry interest was originally designed to mitigate legitimacy problems at the European level. Each ESA has been given a Stakeholder Group. These Groups were founded to enhance the participation of market actors and other stakeholders in the rulemaking process. This institutional feature is supposed to put the regulatory work of the ESAs in a position to take into account stakeholder expertise. As a result, both efficiency and accountability are supposed to increase. The Stakeholder Groups are regarded as regulatory interlocutors of the ESAs with a “direct accountability to the public at

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⁹⁵ The prevailing notion of democratic accountability of administrative authorities among German legal scholars is heavily shaped by the works of great public law scholars: the constitutional court judges Ernst-Wolfgang Böckenforde and Roman Herzog, for example. Their concept of a “legitimacy chain” (Legitimationskette) today remains one of the most influential theories of democratic legitimacy. According to this powerful metaphor a governmental decision is only democratically legitimate if it is connected to the legitimacy chain that runs from the publicly elected offices, i.e. the German parliament, down the hierarchy of sovereign power. Such a connection of a lower governmental office is established by appointment (personal democratic legitimacy) and power to instruct (substantial democratic legitimacy). For an account in English, see Michael Haus, Mirror of the State or Independent Image? – Conceptual Perspectives on the Question of a Legitimacy Shift to the Output Dimension in Local Democracy, 7 URB. RES. & PRACT. 123 (2014); see also Martin Selmayr, Book Review, 43 COMMON MKT. L. REV. 886, 888 (2006). For an application of the theory to international organizations, see Markus Krajewski, Democratic Legitimacy and Constitutional Perspectives of WTO Law, 35 J. WORLD TRADE 167, 175–76 (2001). Some German scholars harshly criticize the ESA against the background of this particular notion of democracy. See, e.g., Dirk Looschelders & Lothar Michael, Europäisches Versicherungsrecht, in EUROPÄISCHES SEKTORALES WIRTSCHAFTSRECHT § 11 ¶ 46 (Matthias Ruffert ed., 2013) (Ger.) (“Ihr Hauptorgan, der Rat der Aufseher, ist weder auf nationaler noch auf europäischer Ebene durch Wahlen oder parlamentarische Verantwortlichkeit rückgebunden.”) (“Their [the ESAs] main body, the Board of Supervisors, is neither on a national nor on a European level legitimized by elections or by accountability to the parliament.”).
large." To serve these purposes, the Groups consist of about thirty members selected to represent a balanced proportion of interested parties, such as industry associations, employees, consumers, users, and academics. The Groups have been integrated into the rulemaking process of the ESAs. Opinions of the Stakeholder Groups have to be requested in the case of implementing and regulatory technical standards, and their opinions “shall” be requested when the ESAs draft guidelines. The ESAs can therefore rely on a steady influx of public input and expertise when drafting new guidelines. When “appropriate,” the ESAs are called on to conduct public consultations and to request the opinion of their respective Stakeholder Group. These requirements have been taken very seriously by the ESAs: the EIOPA, for instance, has so far conducted public consultations and requested the opinion of its Stakeholder Groups in all of its rounds of guideline-drafting.

Even though the Stakeholder Groups are designed to add a deliberative element, recent studies have shown that their input may not be as balanced as required by the ESA Regulations. Iglesias-Rodríguez even concludes that the design of stakeholder participation “suggests that the financial industry may have been able to capture both the legislature and the ESAs, so as to ensure that the advice provided to the latter in the course of the rulemaking procedures

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97. ESMA Regulation, *supra* note 5, at art. 37 2 (“The Securities and Markets Stakeholder Group shall be composed of 30 members, representing in balanced proportions financial market participants operating in the Union, their employees’ representatives as well as consumers, users of financial services and representatives of SMEs.”).


99. See ESA Regulations, *supra* note 5, at art. 37 2 (“The Securities and Markets Stakeholder Group shall be composed of 30 members, representing in balanced proportions financial market participants operating in the Union, their employees’ representatives as well as consumers, users of financial services and representatives of SMEs.”).
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sources, predominantly, from the financial industry."\(^{100}\) This sweeping assessment draws from findings that suggest a heavy preponderance of industry interest in the Stakeholder Groups.

First of all, it has been observed that, due to the "biased" interpretation of the ESA Regulations, the composition of the Groups does not make for a balanced representation of all the interests involved. For example, in most instances consultancy firms have been nominated to serve on behalf of the "users" of financial services. However, those firms "provide their own services to financial institutions" and therefore their interest can be "identified, to a great extent, with the interest of their main customers."\(^{101}\)

The representation issue has already led to a serious clash at the European level. Following the formal opening of an inquiry by the European Ombudsman\(^ {102}\) to investigate an alleged breach of European law by a biased composition of the Stakeholder Groups, the EBA and EIOPA chose to dissolve their already established groups and to reappoint them with a more balanced cast. However, when closing the inquiry the European Ombudsman could not help but issue a "critical remark": "The [authorities] failed to ensure an adequate balance between the representatives of the industry, on the one hand, and those of users and consumers, on the other hand, when selecting members of the IRSG and the OPSG."\(^ {103}\) A complaint against the ESMA's newly

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100. PABLO IGLESIAS-RODRÍGUEZ, THE ACCOUNTABILITY OF FINANCIAL REGULATORS – A EUROPEAN AND INTERNATIONAL PERSPECTIVE 288 (2014). From the beginning, limiting industry influence in the Stakeholder Groups has been identified as one of the major problems in this regard. See Moloney, supra note 52, at 80.

101. IGLESIAS-RODRÍGUEZ, supra note 100, at 261. The industry's dominance is further bolstered by the Stakeholder Groups' internal rules of procedure, a combination that is said to cause an "asymmetric allocation of powers" among their members. Id. at 262--64.

102. The European Ombudsman is an independent official that is elected by the European Parliament to deal with complaints of the European citizens. See TFEU art. 228. She has no binding legal powers and is only authorized to examine complaints and report on her investigations to the European Parliament. However, her influence has been described as politically significant and growing. See Alexandros Tsadiras, The European Ombudsman’s Remedial Powers: An Empirical Analysis in Context, 38 EUR. L. R. 52, 57 (2013).

established Stakeholder Group has already been filed.\textsuperscript{104}

Second, sample analysis of the ESAs' open and public consultations show that consumer and retail groups are absent from these processes.\textsuperscript{105} This observation is in line with studies of consultations of the Commission.\textsuperscript{106} Whereas “companies from the finance sector, especially banks” are generally present,\textsuperscript{107} consumer representatives seem to simply not participate in consultations regarding measures that do not directly affect consumer-protection matters. This has been attributed to the high complexity of the matters discussed.\textsuperscript{108} Complexity might increase participation costs to a level that only well-resourced industry players can afford. Furthermore, there might be certain areas in which consumer or user interests are simply not directly implicated. It is, for instance, hard to extract the consumer-protection implications of banking-capital or insurance-solvency requirements without reverting to trivial generalities. This puzzle has been integrated into the institutional structure of some Stakeholder Groups: only one of the EIOPA's consumer representatives was a member of the subgroups concerned with the reform of the Solvency II regimes.\textsuperscript{109} Stakeholder and public participation in this regard is therefore reduced to a briefing by industry.

A third point that long has been of rather subordinate interest is the

\begin{footnotesize}
\begin{enumerate}
\item See IGLESIAS-RODRIGUEZ, supra note 100, at 266–67 (three case studies). Another example is the public and open consultation on the Guidelines on Forward Looking Assessment of Own Risks (based on the Own Risk and Solvency Assessment principles). All of the 797 comments received by EIOPA were made by either insurers, their interest groups, or their counsel. See European Insurance and Occupational Pensions Authority [EIOPA], Final Report on Public Consultation No.13/009 on the Proposal for Guidelines on Forward Looking Assessment of Own Risk (2013), available at https://eiopa.europa.eu/Publications/Consultations/EIOPA-13-414_Final_Report_on_CP09.pdf.
\item Id. at 269.
\item See IGLESIAS-RODRÍGUEZ, supra note 100, at 267. See also Marxsen, supra note 106, at 278 (additionally blaming a structural deficiency: “In finance and business-related fields that form the centre of the EU's policies, by contrast, not-for-profit intermediary organisations are very rare.”).
\item See EIOPA, Annual Report 2013: Annex IV-Overview of EIOPA Stakeholder Groups Membership, at 90–93 (2013), available at https://eiopa.europa.eu/Publications/Reports/Annual_Report_2013_01.pdf. Solvency II is an act that regulates the European insurance market. Its main parts concern the capital that EU insurance companies are obliged to hold in order to reduce their risk of insolvency.
\end{enumerate}
\end{footnotesize}
national authorities' personnel. Whereas the European Commission is staffed by civil servants who are supposed to spend their professional lives in the European civil service, the European agencies are mostly staffed with short-term employees. The ESAs are not different in this regard: almost all of their employees are temporary staff. According to the ESA Regulations, EU staff regulations apply to the ESAs' personnel as well. Those lay down a mandatory one-year and a flexible two-year cooling-off period for the Chairperson and the Executive Director before they are allowed to enter the private sector. Regular staff members are only subject to a flexible cooling-off period of two years that must be expressly triggered by the authorities' Executive Director. Furthermore, the authorities compete with an industry that is able to offer high pay and attractive job prospects. These circumstances lead to a higher risk of revolving-door problems. The EBA, for example, as a young and still-growing administrative agency, has an annual staff turnover of 12.9 percent due to "resignation, contract expiry or

110. See, e.g., IGLESIAS-RODRÍGUEZ, supra note 100, at 268–69. These remarks are focused exclusively on the senior management of the ESA. However, day-to-day work such as drafting Guidelines and evaluating remarks of Stakeholders will not be done by the Chair and the Executive Director of the ESA. Those tasks rest with the regular staff of the authorities.


112. Staff Regulations of Officials and the Conditions of Employment of Other Servants of the European Community and the European Atomic Energy Community (EEC & EAEC) No. 31/11 of Jan. 2014, arts. 11, 16 § 3 2014 O.J. (C 45/1385), 19, 21 ("In the case of former senior officials as defined in implementing measures, the appointing authority shall, in principle, prohibit them, during the 12 months after leaving the service, from engaging in lobbying or advocacy vis-à-vis staff of their former institution for their business, clients or employers on matters for which they were responsible during the last three years in the service.").

113. Id.

114. Conditions of Employment (EEC & EAEC) No. 31/11 of Jan. 2014, art. 11 2014 O.J. (C 45/1385), 19; Conditions of Employment (EEC & EAEC) No. 31/11 of Jan. 2014, art. 16 § 3 2014 O.J. (C 45/1385), 21 ("Officials intending to engage in an occupational activity, whether gainful or not, within two years of leaving the service shall inform their institution thereof using a specific form. If that activity is related to the work carried out by the official during the last three years of service and could lead to a conflict with the legitimate interests of the institution, the appointing authority may, having regard to the interests of the service, either forbid him from undertaking it or give its approval subject to any conditions it thinks fit. The appointing authority shall, after consulting the Joint Committee, notify its decision within 30 working days of being so informed. If no such notification has been made by the end of that period, this shall be deemed to constitute implicit acceptance.").
2. Cultural Capture

However, these institutional pathways may be only the tip of the iceberg of industry influence. The financial crisis did not only bring on massive change to the regulatory system but also an important stimulus to academic analysis. One of the new fields of academic interest stands in the tradition of a decades-old concept: cultural capture.\textsuperscript{116}

The underlying theory is said to originate with the works of the young Samuel P. Huntington in 1952.\textsuperscript{117} Its basic claim is that regulated actors "capture" their regulators over time and impose their interests on them. The economic narrative of capture occurring naturally had a blunt corruption element to it\textsuperscript{118}: politicians and administrative officials design regulations according to the industry's demands in exchange for votes, resources, and funding.\textsuperscript{119} But this rather simplistic interpretation of capture as a quid-pro-quo bargain has over the years been complemented by a more nuanced view of its structure. Not only

\begin{itemize}
\item \textsuperscript{116}See Daniel Carpenter, David Moss & Melanie Wachtell Stinnett, Lessons for the Financial Sector from Preventing Regulatory Capture: Special Interest Influence, and How to Limit it', in Making Good Financial Regulation - Towards a Policy Response to Regulatory Capture 70, 74 (Stefano Pagliari ed., 2012) (sounding the bell for a "new scholarly understanding of regulatory capture").
\item \textsuperscript{117}See the famous article by Samuel P. Huntington, The Marasmus of the ICC: The Commission, the Railroads, and the Public Interest, 61 YALE L.J. 467 (1952) (dealing with the "marasmus" of the Interstate Commerce Commission (ICC), which is considered the academic starting point of the capture theory). However, it was Marver H. Bernstein in Regulating Business by Independent Commission 74 (1955), as well as George J. Stigler in The Theory of Economic Regulation, 2 BELL J. ECON. MANAG. SCI. 3 (1971), who made the theory of regulatory capture an academic commonplace. For an overview over the history of the theory, see also William Novak, A Revisionist History of Regulatory Capture, in Preventing Regulatory Capture – Special Interest Influence and How to Limit It 7–9 (Daniel Carpenter & David Moss eds., 2014) [hereinafter Preventing Regulatory Capture].
\item \textsuperscript{118}See James Kwak, Cultural Capture and the Financial Crisis [hereinafter Kwak, Cultural Capture], in Preventing Regulatory Capture, supra note 117; David F. Engstrom, Corralling Capture, 36 HARV. J.L. & PUB. POLY 31 (2012) ("materialist capture").
\item \textsuperscript{119}See Stigler, supra note 117, at 12; see also Richard A. Posner, The Concept of Regulatory Capture: A Short, Inglorious History, in Preventing Regulatory Capture, supra note 117 ("A regulatory program was a commodity purchased by the regulated industry."); Ernesto Dal Bó, Regulatory Capture: A Review, 22 OXFORD REV. ECON. POLY 203, 212 (2006) ("the regulated firm will use either bribes or some form of coercive inducement").
\end{itemize}
did the perceived aim of capture shift from regulatory to deregulatory but, more importantly, new mechanics of how capture can occur and be sustained have been explored.

First of all, it has been established that the corrupting mechanism of capture is of a rather indirect nature: agency officials seldom accept direct bribes, but want to further their careers and therefore strive to be on good terms with industry. Outright corruption and bribery might still occur but are the exceptions that prove the rule. "Revolving doors," however, are of high importance and might not only be a cause but also a symptom of another, psychological mechanism of capture.

It was Willem Buiter, who, in the wake of the latest financial crisis, first argued that the homogenous cultural environment in which regulatory as well as corporate experts are educated, trained, and employed might have led to a shared mindset, which naturally resulted in shared views on regulation. In such an environment, capture occurs not because of criminal or corrupt behavior but because of sincere conviction and a heavy educational and social bias. This notion of a "cognitive capture" has been further elaborated by other scholars and.

120. See Daniel Carpenter, Corrosive Capture?, in PREVENTING REGULATORY CAPTURE, supra note 117 (arguing that the traditional notion of capture being used by the industry as a tool to limit market access is outdated. Industries rather try to avoid or ease regulations [corrosive or deregulatory capture]). However, these findings are not undisputed. Richard A. Posner, for instance, argues that the weakening of regulation is not another version of regulatory capture but rather something completely different. See Posner, supra note 113, at 49 et seq.: capture, according to his account, means only the industry’s influence on regulations to protect its market share from competition. What at first looks like a serious attack on the capture mechanisms discussed here, turns out to be a mere fight about words. Posner does not deny the new shape of influence exerted by the industry but rather points at the “misleading” placing of the new theory. Capture, as defined by him, has no room for these new findings. I will, however, use the term “capture” as it is used by the proponents of the “corrosive capture theory” since a relaxed terminology seems most promising in this regard.

121. See C. Boyden Gray, Congressional Abdication: Delegation Without Detail and Without Waiver, 36 HARV. J.L. & PUB. POL’Y 41, 49 (2012); Stigler, supra note 117, at 13 (offering a different perspective: “Why are so many politicians lawyers? – because everyone employs lawyers, so the congressman’s firm is a suitable avenue of compensation, whereas physicians would have to be given bribes rather than patronage.”).


resulted in the notion of "cultural capture." According to this approach, capture is a result not only of material incentives but also of other mechanisms such as identity, status, and relationships. The core argument is that decision-makers are influenced rather subconsciously by their environment and therefore structurally favor a certain interest group. Factors such as race, training, and shared economic priorities (together, identity); social, scientific, or economic achievements (together, status); and personal, professional, or other relationships dominate this environment. As a result, regulators are consistently under the "soft pressure" of the regulated industry and capture occurs silently and almost inevitably.

Cultural capture, therefore, is not fueled by corruption or dishonesty, but rather by a commitment to certain key priorities shared among regulators and industry. If this holds true, it casts the role of expertise in financial regulation in an interesting light: expertise might


124. See Kwak, Cultural Capture, supra note 118, at 78 (rightly noting the notion of "deep capture" as described by Jon Hanson and David Yosifon bears at least some similarities to cultural capture). Regulatory capture according to the deep-capture hypothesis is also a rather hidden mechanism that does not involve corrupt behavior on behalf of the captured. However, in its far-reaching hypothesis that capture is a global phenomenon that was intentionally created to further commercial interests, it goes far beyond the rather modest claims of cultural capture. See Jon Hanson & David Yosifon, The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture, 152 U. PA. L. REV. 129, 229-30 (2003) ("Our basic hypothesis (and prediction) is that large commercial interests act (and will continue to act) to capture the situation—interior and exterior—in order to further entrench dispositionism. Moreover, they have done so largely undetected, and without much in the way of conscious awareness or collaboration. Hence, large corporate interests have, through disproportionate ability to control and manipulate our exterior and interior situations, deeply captured our world.").

125. See Kwak, Cultural Capture, supra note 118, at 80 et seq.
126. See id. at 81-85.
127. See id. at 86-89 (emphasizing that it is of secondary importance in which field such status is achieved. He specifically names the financial sector, which gained status via charity, pop-cultural appraisal, and scientific affiliation).
128. See id. at 89-93.
129. Id. at 93.
130. Engstrom, supra note 118, at 33 (arguing that this is a result of the definitional vagueness of the public-good conception. In his words, it shows "the more general problem ... that virtually any policy position can be framed as furthering the public interest." Indeed, the deep expertise required to fully understand financial regulations and their impact on the regulated industry makes their assessment especially hard. Even if a legislative decision is made laying down what the "public interest" with regard to a specific financial markets topic is, the guise of expertise can exacerbate the information asymmetry between legislature and enforcing agency to a point in which the principal's control becomes a mere myth.).
always already come “captured” to a certain degree. Regulation in this field might therefore need a steady, synthetic influx of public interest.

3. Conclusion: Legitimacy Concerns Persist

Unlike the concern for weak enforceability, to which the ESA Guidelines seem mostly immune, the Guidelines seem not to be immune to the problems of preponderant industry interest. The institutional structures of both the ESAs and the regulatory environment of the financial markets raise the question of whether the authorities are sufficiently capable of withstanding powerful industry interests. It seems that consumer input is almost absent in matters that are not directly related to their concerns. These issues, however, are of high importance and require balanced input.  

Furthermore, research suggests that capture might be a phenomenon that cannot be reduced to corrupt regulators or to insufficient postemployment policies of the supervisory agencies. It rather implies that capture might occur because of shared cultural or cognitive mindsets. If this is true, supervisory authorities would be inherently biased and per se give preference to industry-preferred solutions.

II. ESA Guidelines as Nonbinding Rules

Part I leaves us with a thought-provoking portrayal of the ESA Guidelines. They resemble hard law in their effect, but lack the legitimacy safeguards of the legislative process. Their specific subject matter, which requires steady industry and expert input, rather seems to make them especially vulnerable to preponderant industry interest. Why then did the European legislature resort to this soft-law tool? It certainly did not introduce the ESA-Guideline as an experiment. Soft guidance is far from unknown in the European legal sphere. Due to the open and developing structure of the European Union, European

131. In the same vein, see Marxsen, supra note 106, at 278 (“A lack of public interest and relevance can certainly not be the reason for such an under-representation. A lack of public interest might be assumed in regard to very few consultations that address politically irrelevant subjects. This is, however, certainly not true for many of the economical issues that were subject of a consultation. The consultations on, for example, measures to strengthen bank capital requirements, on regulations for credit rating agencies, or on the pricing of medicine received almost no participation of not-for-profit groups, although the practical relevance, especially in light of the current economic crisis, is evident. A public interest is definitely given, but it has not gotten to get organised in a way that would intervene at the institutional European level.”).
institutions, first and foremost the European Commission, have been using all sorts of soft guidance tools.\textsuperscript{132} In contrast to the global sphere, however, the European Union can rely on specific grants of jurisdiction that entitle the European legislature to regulate the financial markets by hard law. Over the last years, especially Articles 53 and 114 TFEU have been used to adopt numerous legislative measures to reform the financial markets. The European Parliament and Council also delegated significant legal powers to the Commission, which is in charge of further defining and shaping the framework legislation.\textsuperscript{133} However, when founding the ESAs, the European legislature equipped the three sister authorities with a soft-law instrument that, in addition to these binding acts, should shape the financial markets. Against the background of the existing legal powers this approach seems unusually restrained.

A. Why Soft Law?

An obvious answer to this question is that the ESAs, as European agencies, might simply be ineligible for legislative powers. Agencies such as the ESAs are a very common phenomenon in the European regulatory sphere.\textsuperscript{134} Their legal foundation and range of possible powers, however, are still an open question. The European treaties do not include an explicit competence to establish agencies and do not speak of agency competencies. Until recently it was not even settled whether Article 114 of the TFEU, the treaty provision on which the European legislature relied to establish most of the newer European agencies, could be used to establish institutions that were entitled to issue binding decisions.\textsuperscript{135} The ESAs' establishment indirectly led to long-awaited clarification in this regard by the European Court of

\textsuperscript{132} For an empirical and dogmatic overview, see Armin von Bogdandy et al., Legal Instruments in European Union Law and Their Reform: A Systematic Approach on an Empirical Basis, 23 Y.B. EUR. L. 91 (2004); LINDA SENDEN, SOFT LAW IN EUROPEAN COMMUNITY LAW (2004).

\textsuperscript{133} For a discussion of the Lamfalussy procedure see generally supra notes 75–90 and accompanying text.

\textsuperscript{134} For a historical overview, see Madalina Busuioc et al., The Phenomenon of European Union Agencies: Setting the Scene, in THE AGENCY PHENOMENON IN THE EUROPEAN UNION: EMERGENCE, INSTITUTIONALISATION AND EVERYDAY DECISION-MAKING 3 (Madalina Busuioc et al. eds., 2012).

\textsuperscript{135} For an introduction into the discussion about Article 114 of the TFEU, see MADALINA BUSUIOC, EUROPEAN AGENCIES: LAW AND PRACTICES OF ACCOUNTABILITY 15–18 (2013); see also Elaine Fahey, Does the Emperor Have Financial Crisis Clothes? Reflections on the Legal Basis of the European Banking Authority, 74 MOD. L. REV. 581 (2010).
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136. The ESAs' extensive powers had been viewed as a massive overreach by the European legislature, bending the European treaties to and beyond their breaking point. As a result, the United Kingdom filed an action for annulment against one of the most controversial competencies: the power to ban short sales. In its judgment, the Court of Justice of the European Union (CJEU) held that the power to issue binding decisions could be conferred to a European agency under the provisions of Article 114 of the TFEU, see Case 270/12, United Kingdom v. Council and Parliament, 2014 EUR-Lex CELEX LEXIS 45-54 (Jan. 22, 2014); for a discussion of the decision, see Carmine Di Noia & Matteo Gargantini, Unleashing the European Securities and Markets Authority: Governance and Accountability After the ECJ Decision on the Short Selling Regulation (CASE C-270/12), 15 EBOR 1 (2014); Miroslava Scholten & Marloes van Rijsbergen, The Limits of Agencification in the European Union, 15 GERMAN L.J. 1223 (2014); Rob van Gestel, European Regulatory Agencies Adrift?, 21 MAASTRICHT J. 188 (2014); Craig, supra note 61, at 201. This granted the ESAs much-needed relief, since the ambiguous legal situation had hung like the sword of Damocles above their head. See van Gestel & van Golen, supra note 16, at 774.


Justice's (ECJ) short-sales-ban ruling (SSBR). On a second issue the ECJ proved to be less effective. One of the most difficult questions in EU administrative law is whether EU agencies can be entrusted with legislative powers under European law. Most commentators agree that even if certain decision-making powers can be delegated to agencies, European law does not provide for a lawmaking agency. This restrictive view is rooted in the Meroni decision of the ECJ, which dates back over half a century and in ancient Greek political thought it "became the political virtue par discretion which may, according to the use which is made of it, make possible the execution of actual economic policy" cannot be transferred to bodies that are not mentioned by the treaties. The debate about the application, implications, and continuing validity of the Meroni judgment was only partially answered by the SSBR of the ECJ.

First, the court applied the Meroni criteria to the ESMA, affirming their significance for bodies of public authority that exercise powers
directly conferred on them by the European legislature.139 Second, the ECJ ruled that, as long as the delegated powers are “circumscribed by various conditions and criteria which limit” the implied discretion margin, such delegation meets the Meroni requirements.140 However, the judgment concerned decision-making powers of the ESMA, which differ substantially from legislative powers. Thus, even though the ECJ confirmed that, under European law, agencies can be empowered to make decisions with legal consequences, it is far from certain that this also entails the possibility to delegate legislative powers to an agency.141

However, when the ESAs were established in 2011, the SSBR was not even contemplated. The European legislature, therefore, chose a very cautious approach to the Meroni doctrine and resorted to a circumvention technique that respected the wording of the treaty but, at the same time, gave the ESAs as much legislative influence as possible.142 Commentators have therefore called the ESAs’ competencies “quasi-rule-making” powers.143 However, even this limited authority still involves a fairly high number of actors and needs a legislative mandate to be activated. The ESAs might be in the driver’s seat, but under parental supervision and without a car of their own.

By contrast, ESA Guidelines can be issued by the ESAs without the interference of any other European actor. Guidelines do not need a mandate or a prior approval to be published. They are flexible and time-efficient tools to regulate the financial markets. Their success, however, leads them steadily to outgrow their original purpose. Even though the ESA Guidelines are third-level acts under the Lamfalussy procedure, it

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139. Case 270/12, United Kingdom v. Council and Parliament, 2014 EUR-Lex CELEX LEXIS ¶¶ 45–54 (Jan. 22, 2014). Because the Meroni decision concerned a private entity that had been delegated powers by the High Authority, some scholars argued that the requirements were not applicable to public authorities, while others argued that, at least in cases in which the European legislature directly conferred powers to an entity, Meroni did not apply. See Dragomir, supra note 137, at 275–76.


141. However, some scholars argue that the judgment could be interpreted in this way. See van Gestel, supra note 136, at 195–96, for a critical analysis of the judgment in that direction; see also Scholten & van Rijssbergen, supra note 136, at 1255. But see Di Noia & Gargantini, supra note 136, at 40–41 (giving a rather positive implication).

142. See ESA Regulations, supra note 5, at art. 10 ¶ 1, art. 15 ¶ 1. By a special procedural modification of Article 290 and Article 291 of the TFEU, the ESAs were given the right to initiate the drafting process of so-called “implementing technical” and “regulatory technical” standards. These are second-level legal instruments of the so-called Lamfalussy procedure. See supra notes 75–90 and accompanying text. Though the Commission still has to endorse those standards to make them binding law, it can only refuse to do so when the “Union’s interests” requires such a refusal.

143. Busuioc, supra note 16, at 115; see also van Gestel & van Golen, supra note 16, at 767 et seq.; Di Noia & Gargantini, supra note 136, at 19; Craig, supra note 61, at 206.
has been observed that ESAs engage in "level-hopping": they lay down rules that are either not implied in the framework directives or go far beyond a simple interpretation of existing law.\textsuperscript{144} The EIOPA, for example, will issue a massive regulatory apparatus to phase in the Solvency II directives\textsuperscript{145} and in another instance has issued guidelines that have raised doubts about its lawful rooting in European law.\textsuperscript{146} Such level-hopping does not necessarily occur against the will of the European legislature. The EBA, for example, was requested to issue guidelines under both the Capital Requirements Regulation (CRR) and Capital Requirements Directive IV (CRD IV)\textsuperscript{147} that have far-reaching consequences for banks' capital requirements.\textsuperscript{148} ESAs are therefore at least in some cases using the Guidelines to compensate for a lack of legislative power.\textsuperscript{149} But in contrast to the global sphere, these nonbinding measures become an integral part of a coherent body of binding provisions and draw legal relevance from that body's authority. They do not need to be transposed by an elaborate legislative procedure, but can be enforced by the supervisory authorities through the application of already existing legal provisions.

B. Rules vs. Principles

A thorough look at the regulatory system shows that the

\textsuperscript{144} See also Wymeersch, supra note 52, at 276, para. 9.164 ("In some cases there has been evidence that they are used for bridging the differences of opinions, both at Level 1 or at the level of delegated regulation.").

\textsuperscript{145} See Introducing Solvency II, EIOPA, http://archive.eiopa.europa.eu/activities/insurance/solvency-ii/index.html (last modified Dec. 14, 2014) ("Set 1: 'Guidelines relevant for approval processes, including Pillar 1 (quantitative basis) and internal models,'" and "Set 2: [sic] 'Guidelines relevant for Pillar 2 (qualitative requirements) and Pillar 3 (enhanced reporting and disclosure).'").


\textsuperscript{148} See, for example, CRR, supra note 147, at art. 128 para. 3, which requires the EBA to issue guidelines specifying which types of exposures are associated with particularly high risk and under which circumstances. These items will have to be assigned a 150% risk weight, id. at art. 128 para. 1., which will have a considerable impact on the capital requirement of an institution.

\textsuperscript{149} See van Gestel & van Golen, supra note 16, at 778.
circumvention of the existing restrictive requirements of European law might not have been the only reason why the European legislature chose to establish the ESA Guidelines. Their legal nature as soft law induces another interesting effect. The interaction of nonbinding requirements, on the one hand, and the underlying binding law, on the other, leads to a combination of rule and principle that seems to activate the benefits of both regulatory techniques.

In the discussion of regulation techniques, the dichotomy of rules and principles is commonplace. Rules are detailed regulations precisely laying out the duties and rights of a regulated entity, whereas principles (or standards)\textsuperscript{150} stipulate rather broad “regulatory objectives and values, and regulatees are left free to devise their own system for serving such principles.”\textsuperscript{151} Previously, the discussion focused mainly on the shortcomings of a rule-based approach. It has been identified as “too long and complex to understand readily or to enforce,”\textsuperscript{152} slow,\textsuperscript{153} probably expensive,\textsuperscript{154} and ill informed.\textsuperscript{155} The often rigid formulation of rules was said to suffer from “over-” as well as “under-inclusiveness.”\textsuperscript{156} Therefore, it was not surprising that the principles-based approach became the international and European model of choice for regulating

\begin{itemize}
  \item \textsuperscript{150} As to terminology, the terms \textit{principle} and \textit{standard} are often used interchangeably when describing regulatory technique. The U.S. discussion in particular uses the term \textit{standards} when describing “instruments which encourage the ‘pursuit or achievement of a value, a goal or an outcome, without specifying the action(s) required’ to achieve this in contrast with a legal rule,” see Colin Scott, \textit{Standard-Setting in Regulatory Regimes, in THE OXFORD HANDBOOK OF REGULATION 104, 105 (Robert Baldwin et al. eds., 2010).} This Article will use the term \textit{principle}, because this term is the more common in this European context. For a detailed discussion of the terminology, see Lawrence A. Cunningham, \textit{A Prescription to Retire the Rhetoric of “Principles-Based Systems” in Corporate Law, Securities Regulation and Accounting}, 60 VAND. L. REV. 1411, 1418-19 (2007).
  \item \textsuperscript{151} \textit{ROBERT BALDWIN, MARTIN CAVE & MARTIN LODGE, UNDERSTANDING REGULATION: THEORY, STRATEGY, AND PRACTICE} 302 (2d ed. 2012).
  \item \textsuperscript{152} \textit{Id. at 230}.
  \item \textsuperscript{153} \textit{See Moloney, supra note 94, at 440 (explaining how the rapid growth and innovation in financial markets over the past 30 years have made it difficult for regulations to keep pace).}
  \item \textsuperscript{154} \textit{For an economic analysis, see ANTHONY OGUS, REGULATION: LEGAL FORM AND ECONOMIC THEORY} 166 passim (2d ed. 2004).
  \item \textsuperscript{155} \textit{See BALDWIN, CAVE & LODGE, supra note 151, at 231. For an economic analysis of rule-making, see generally Isaac Ehrlich & Richard A. Posner, \textit{An Economic Analysis of Legal Rulemaking}, 3 J. LEGAL STUD. 257 (1974) (exploring the four cost dimensions of rule-making, rule enforcement, rule compliance, and rule violation)}.
  \item \textsuperscript{156} \textit{See FREDERICK SCHAUER, PLAYING BY THE RULES: A PHILOSOPHICAL EXAMINATION OF RULE-BASED DECISION-MAKING IN LAW AND IN LIFE} 31-34 (1993).}
\end{itemize}
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financial markets. Even though a “pure” principles-based system was
never established, the effort of the European legislature to observe the
essentials of principles-based regulation was clearly noticeable.

Indeed, a principles-based approach to regulation promised a staggering
number of benefits. First of all, in multilevel governance structures such
as the European Union, a principles-based approach left national
regulators with enough choices to engage in regulatory competition with
one another. Even more importantly, this style of regulation promised
a more flexible regulator in “rapidly innovating financial markets.”

It was seen as a new “bargain” between the regulators and industry that
provided market participants with room for maneuver to increase
efficiency but without discharging them from their legal duties—a
concept which also structurally included knowledge and resources of the
regulated entity and which was therefore sometimes simply called
“smart regulation.”

The financial crisis called these hopes into question. Certain
developments such as “gold-plating” or regulatory regionalism, which
are made possible by principles-based regulation, have been identified
as reasons for the catastrophic failure of European financial regulation
during the crisis. However, scholars are cautious to condemn
principles-based regulation wholesale, as the alternative is still deemed
to be ineffective and inefficient.

157. See Moloney, supra note 94, at 447–48. See generally Julia Black, Forms and
Paradoxes of Principles Based Regulation, 3 CAP. MKTS. L.J. 425 (2008) (providing an
overview of principles-based regulation).

158. See, e.g., Black, supra note 157 (describing the principle-favoring mood on the
European level in general); see also Borut Stražišar, Is Principle Based Legislation Smart
Choice for Capital Market’s Regulation?, 1 J. GOVERNANCE & REG. 107 (2012) (for the
capital markets sector); Michel Dacorogna & Philippe Keller, SCOR, Principle-Based
Solvency: A Comparison Between Solvency II and the Swiss Solvency Test (2010),
solvency_ii_va2.pdf (for the insurance sector).

159. See Moloney, supra note 94, at 452.

160. Moloney, supra note 94, at 448. For a discussion of the cost-saving nature of
principles when it comes to altering legal requirements, see Emanuela Carbonara &
Francesco Parisi, Bargaining for Legal Harmonization: Jurisdictional Competition and
Legal Obsolescence, in INTERNATIONALIZATION OF THE LAW AND ITS ECONOMIC ANALYSIS
339, 348 (Thomas Eger et al. eds., 2008).

161. See Black, supra note 157, at 430.

162. See Moloney, supra note 94, at 447.

163. See Black, supra note 157, at 431.

164. See DRAGOMIR, supra note 137, at 153 passim; Ferran, supra note 137, at 42
passim.

165. See, e.g., Cristie Ford, Principle-Based Securities Regulation in the Wake of the
contains cautionary lessons about the risks associated with principles-based regulation
By contrast, the European legislature seemed to drastically change its approach. One of the main aims of its massive regulatory program is to establish a “consistent application of legally binding Union acts” and to prevent further “regulatory arbitrage.” The European Union’s principles-based approach and its concomitant empowerment of industry actors today is shaped by a more cautious plan of action. An unprecedented wave of regulation has flooded the financial markets. However, the European legislature mostly resorted to directives, which are not directly applicable to the Member States but have to be transposed into respective national law. The desired degree of coherence is supposed to be achieved by second- and third-level measures. But the ESAs’ third-level acts have been “upgraded”: the ESAs are authorized to issue nonbinding guidelines that, despite their soft-law nature, have certain legal implications. Consequently these guidelines are meant to be one of the central means of “ensuring the common, uniform and consistent application of Union law.” The content of most ESA Guidelines qualifies them as perfect examples of rules, as they contain detailed requirements for both national supervisory authorities and thereby market participants.

C. ESA Guidelines as Supervisory Default

However, it is far from certain that the European legislature once again has completely turned to a rules-dominated style of regulation. Against the background of the rules-vs.-principles discussion and its almost entirely functional perspective, ESA Guidelines as nonbinding

when it is not reinforced by a meaningful regulatory presence. However, the response cannot be a knee-jerk reversion to either a more rules-based or a more command-and-control approach. Principles-based regulation accompanied by input from industry was a direct response to a situation where regulators were underinformed, always playing catch-up, and made fools not only by Enron-style corporations engaging in ‘loophole behaviour’, but also (to harken back to the negative image of 1970s bureaucracies) by their own rigid, seized-up processes.”

166. See ESA Regulations, supra note 5, at art. 8 ¶ 1(b). For an analysis of the overall rather critical perception of principles-based regulation after the financial crisis from the British perspective, see Moloney, supra note 94, at 448–49.


168. Second-level instruments are both delegated and implementing acts that are issued by the European Commission, and in some instances prepared by the ESA. For a short description of the Lamfalussy process, see supra notes 75-90 and accompanying text.

169. See supra Part I.B.2.

170. ESA Regulations, supra note 5, at art. 16 ¶ 1.
rules constitute their own category. Even though they are clearly not inspired by a principles-based regulatory approach, their legal nature as *soft law* endows them with a flexibility that recalls principles-based governance. Indeed, if we take a close look at the two-part structure that constitutes the specific regulatory technique of the ESA Guidelines, we can observe an arrangement that, at least in theory, combines the strengths of both rules and principles.

Most ESA Guidelines are issued to specify the requirements of legally binding acts which, in their broad wording, seem principle-like. ESA Guidelines have the capability to establish a common understanding about these requirements and at the same time leave national supervisors with at least some room to maneuver. The underlying legally binding requirements remain principles only, but have been further specified and given a more concrete meaning. The Guidelines draw their limited legal significance from the underlying principle. Their de facto relevance is established by their application, which at the same time is the application of the underlying principle. However, they remain de jure insignificant. Neither courts nor supervisors are bound by them directly. If the perspective of legal relevance is added to the analysis of ESA Guidelines as rules, a specific set of characteristics arises that does not fit the common rules-principles dichotomy. It rather seems as though the functional profile of the Guidelines lies somewhere between the rigid rule and the flexible principle. It constitutes a supervisory default and hence may be a hybrid regulation technique. At the European level, specific requirements are laid down that, from the perspective of the regulated entity, turn into binding supervisory decisions at the national level. The regulator therefore activates all benefits of a rules-based regulation: certainty about legal requirements, a clear signal to regulated entities of what is expected of them, and a proactive construction of the law as it should be applied. At the same time, due to the nonbinding nature of the Guidelines, supervisory authorities and courts are still able to retreat to the underlying principles if they are convinced that the Guidelines do not reflect their regulatory content entirely. This mitigates the major weakness of a rules-based regulation: over- and underinclusiveness.

171. Of course there can be indirect constitutional effects that can lead to a certain degree of self-binding when a supervisor is applying the Guidelines. This, however, remains a question that has to be answered by each Member State. For a short discussion of the European law, see infra Part IV.A.

172. For an instructive overview of the benefits of rules-based regulation see Ehrlich & Posner, *supra* note 155, at 262–67; *see also* Carbonara & Parisi, *supra* note 160, at 348 (providing a shorter overview but in the same vein).
If we take the discussion above into consideration against the background of the increasing number of legislative interventions with regard to the organizational structure of financial institutions, an interesting picture unfolds. The internal configuration of financial institutions has always been the most important part of European financial regulation. In the field of banking, for example, the European legislature took a “gradualist approach” that focused on the licensing system of banks in order to give effect to the freedom of service and establishment. To further bolster trust in the stability of banks entering national markets via passports, the European Union harmonized capital requirements and supervision. When the Basel regime was adopted in the European Union, it added its own sophistication to the regulations, making a certain regulatory technique a core element of European banking law. This technique has been called “subjectivity regulation.” Subjectivity as substantive programming of legal entities implies a more intrusive approach to regulation. It aims at creating a certain organizational fabric of the regulatory target by defining its inner structure. It thereby seeks to predetermine acts of the regulated entity rendering traditional instruments of regulation redundant.

In the special circumstances of the ESA Guidelines this leads to a number of frictions, which are illustrated in the following sections. There are three main issues that gain importance in light of subjectivity regulations. First, the supervisory default of the ESA Guidelines might be too “sticky.” Second, seemingly illegal organizational requirements might take the form of the judicially incontestable Guidelines. Third, since subjectivity in this regard does not only aim at purposely changing its subjects but also deliberately grants stakeholders influence in the drafting process of the nonbinding Guidelines, financial institutions are likely to dominate Guideline-drafting procedures in areas important to them.

174. See id.
175. See Mika Viljanen, Making Banks on a Global Scale: Management Based Regulation as Agencement, 23 Ind. J. Global Legal Stud. 425 (2016) (analyzing management based regulation and the rules of the International Capital Adequacy Assessment Program with agencement theory in order to demonstrate how such rules seek to change their subjects' behavior).
A. Subjectivity and Regulatory Technique

Guidelines, as legally nonbinding instruments, have been identified as a default that can be characterized as a mixture of rules and principles. Most of them are as detailed as rules but all of them lack the legally binding character that is one of the essential features of rules. They therefore draw from the legal validity of the underlying principle to establish their legal effect. Their impact is mainly dependent on their "stickiness": if they are too sticky, they resemble rules and might fall prey to their structural deficiencies.

In the area of organizational requirements, guidelines seem to be of particular value as they enable the European supervisors to establish certain specific duties that need to be followed to comply with broad compliance and capital requirements without excluding different solutions that meet those requirements as well. This could prove especially useful when we are talking about subjectivity regulation. If the inner configuration of financial legal entities such as banks and insurance firms is supposed to ensure their stability and predetermine their actions by using its individual information to calculate a certain modulation, a flexible approach would enable supervisors to fine-tune the settings under the individual circumstances. Especially in the diverse environment of the European Single Market with its wide array of different financial institutions, this approach provides a valuable source of regulatory flexibility. A European "common sense" can be established without running the risk of overenforcement. Furthermore, the soft-law approach could enable supervisors to deviate from the ESA Guidelines in cases in which their default cannot sufficiently enforce the underlying principle.

As discussed above, the ESA Guidelines currently create a strict de facto regime at the European level, which makes deviation improbable. This compliance pressure takes effect not only at the European level but also on their specific application at the national level. Some national supervisors such as the German BaFin transform the Guidelines into legally binding instruments. It can also be observed that some national supervisors such as the BaFin and the Austrian FMA are legally obliged by national law to apply the

176. See supra Part I.B.3.
177. BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) is the German financial markets supervisory authority.
178. See supra note 93.
179. FMA (Finanzmarktaufsicht) is the Austrian financial markets supervisory authority.
Guidelines.\footnote{Compare \textit{Bankweesengesetz} [BWG] [\textit{Banking Act}] \textit{Bundesgesetzblatt} [BGBl] No. 184/2013, as amended, § 69 ¶ 5 (Austria) ("Zu diesem Zweck hat sich die FMA an den Tätigkeiten der EBA zu beteiligen . . . die Leitlinien und Empfehlungen und andere von der EBA beschlossenen Maßnahmen anzuwenden.") ("For that purpose the FMA has to work together with the EBA, . . . apply Guidelines and recommendations and other measures that have been issued by EBA.") (requiring the authority to apply the ESA Guidelines) \textit{with Kreditweesengesetz} [KWG] [\textit{Banking Act}], Jul. 10, 1961, \textit{Bundesgesetzblatt}, Teil 1 [BGBl I], last amended by \textit{Gesetz} [G], Feb. 24, 2012, BGBl I at 206, art. 2, § 7b(1) ¶ 3 (Ger.) ("Sie wendet die Leitlinien und Empfehlungen der Europäischen Bankenaufsichtsbehörde und der Europäischen Wertpapier- und Marktaufsichtsbehörde bei Anwendung dieses Gesetzes an.") ("It [the BaFin] applies the Guidelines and recommendations of the European Banking Authority [EBA] and the European Securities and Markets Authority [ESMA] when applying this act.") (implementing a slightly weaker duty).} Even if such enforcement duties do not exist by law, national supervisors seem to understand the nonbinding Guidelines as interpretations of the law that, when applied, have the same legal effects as a binding act would. The default character of the ESA Guidelines cannot be taken into account by this regime. Such a setting might not leave enough room to adapt to specific circumstances of the individual financial institution. This leads to a configuration under which the Guidelines resemble rules in their effect and therefore become over- and underinclusive.

\textbf{B. Subjectivity and Judicial Accountability}

The turn from only factual effects on national supervisors to legal effects in the relation between national supervisors and financial institutions leads to another problem. The enforcement power of the national supervisors endows the Guidelines with legally binding effects and thereby enables regulation by an instrument that is not contestable at the European level. According to the TFEU, only such measures can be reviewed by the Court of Justice of the European Union (CJEU) as are intended to produce legal effects vis-à-vis third parties.\footnote{TFEU art. 263, ¶ 1.} ESA Guidelines, however, are legally nonbinding. That leads to the rather obvious conclusion that the ESA Guidelines are not contestable before the CJEU. The ESAs are therefore able to heavily shape the internal organization of financial institutions by the means of mere nonbinding tools that are not subject to European judicial review.\footnote{An important question, which will not be considered here, is whether the "comply or explain" mechanism has sufficient legal effect so as to make the Guidelines judicially contestable for Member States and European institutions. In contrast to mere individuals, these institutions are privileged when it comes to contestation of European Union law. Their actions for annulment are not limited to such acts that are "of direct and individual
This situation became a hotly debated issue during the rejection of EIOPA’s “Guidelines on Complaints-Handling by Insurance Undertakings” by the insurance industry. These Guidelines, applying certain very broad compliance requirements of the Solvency II Directive, provided that insurers were obliged to establish an internal complaint-management process. German insurance firms were convinced that this constituted regulatory overreach by EIOPA. The German supervisory authority BaFin did not agree, but instead complied with the Guidelines and published a legally binding collective decree (Sammelverfügung) addressed to German insurers that required them to implement the internal process. Even though the collective decree can be contested in a German court, the situation is regarded as unsatisfactory, especially when considered against the fact that ESA Guidelines enjoy a presumption of lawfulness in German courts. To contest the content of the ESA Guidelines, insurance firms must bring an action of annulment in a German court and pursue this action until the German court of last resort is legally obliged to bring the matter before the CJEU as a preliminary ruling under the TFEU. Such a procedure is likely to take years and, even if successful, to be only of limited help. Furthermore, judicial review by a national court could once again lead to diverging interpretations of European law if the court finds that the interpretation laid down in the ESA Guidelines violates the Member State’s law. The duty to bring a legal question before the CJEU only applies to lower courts if the validity of an act is in question. However, ESA Guidelines, as soft law, are no such acts. This could once again lead to a grab-bag of interpretations and would run contrary to the central aim of the ESA Guidelines: harmonization.

concern to them.” However, this required “personal concern” generally excludes legal and natural persons from a contestation based on the Member States’ “comply or explain” mechanism. See TFEU art. 263 ¶ 4.
184. Id. ¶ 11.
185. See BaFin, supra note 93.
186. See Bundesverwaltungsgericht [BverwG] [Supreme Administrative Court] May 24, 2011, NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT [NVwZ] 1012 (1015) 2011 (Ger.).
187. A preliminary-decision procedure is only limited to the questions presented to the CJEU. See TFEU art. 267. Furthermore, it does not publicly denounce a certain act as legally invalid but rather answers a legal question inter partes. Moreover, a duty of the national courts to initiate a preliminary-decision procedure only exists if the question is raised in “a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law.” Id. art. 267 ¶ 3.
C. Subjectivity and Interest Politics

Another facet of the already complex picture is the special position that the Guideline-drafting procedure grants to financial institutions. They are not only dominant in the Stakeholder Groups and in open and public consultations, but might also be able to enhance this influential position even further through a shared cultural mindset with the authorities’ personnel. What might be troublesome in most instances turns into an even more pressing issue when it comes to the Guidelines. Those soft-governance tools are not only “harder” than their design suggests, but they also lack most procedural safeguards that ensure a balanced public-interest representation. Whereas ESAs are either just consulting authorities in the legislative process or subject to the veto-power of the European Parliament and Council, the ESA Guidelines are an instrument with no other accountability mechanisms attached.

In the case of the long-awaited Solvency II reform, for example, the EIOPA will publish two sets of guidelines that are supposed to “phase in” the new Solvency II regime, which will have taken full effect in January 2016. As an already-published set of preparatory guidelines has shown, it can be safely assumed that insurers and their interest groups will be almost entirely on their own in the open and public consultations. The Stakeholder Groups of the EIOPA will not lead to a diversified look on the matter either, since the stakeholder subgroups concerned with the Solvency II reform are almost exclusively occupied by representatives of the industry and professional associations. Against the background of possible cultural capture, this constellation becomes even more concerning because neither an ex ante nor an ex post check by the European legislature is part of the Guideline-drafting procedure. Even though the EIOPA is only “phasing in” the requirements laid down by the European legislature, its interpretative preassessment of the norms will have a huge impact on actual supervisory practice. Even if the enforcement sets a tone of good regulation, it will be tuned without civil society.

IV. HOW TO COPE WITH ESA GUIDELINES

The three problems discussed above could be addressed by a wide

188. See supra Part I.A.
189. Insurers, their interest groups, or their counsel comprised all of the 797 comments received by EIOPA in the public and open consultation on the Guidelines on Forward Looking Assessment of Own Risks (based on the ORSA principles). See supra note 105.
190. See supra Part I.C.1.
191. Moloney, supra note 94.
range of measures. I limit my suggestions to rather modest legal and institutional reforms. Relying on already-existing case law and legal literature, it will be shown that just a few changes might lead to a more feasible setting of the ESA Guidelines.

A. Sophisticated Noncompliance

Even though the ESA Guidelines have been procedurally upgraded to become quasibinding, their legal nature as nonbinding rules should leave national supervisory authorities, as well as market participants, room to maneuver. Some commentators even advocate a “noncompliance culture,”\textsuperscript{192} or a more principles-based approach to ESA-Guideline regulation.\textsuperscript{193} I would not go as far. The Guidelines should represent the currently enforced legal requirements in most cases. The ESA Regulations clearly state that ESA Guidelines are meant to be means of a “common, uniform and consistent application” of EU law—a purpose that can only be served when Guidelines are consistently followed. According to some scholars, however, ESA Guidelines should not be enforced in so-called “exceptional cases.” This view convincingly claims to follow the precedents of the ECJ. The Court has ruled that, even though the European Commission is bound by its own administrative practices after they have been published, it still may depart from a practice if departure is justified by legitimate reasons.\textsuperscript{194} Such an “exemption clause” takes into consideration the administrative root of the ESA Guidelines, which are meant to be an interpretive tool that lacks the binding quality of legal rules. Furthermore, it mitigates the risk of overinclusiveness, which is brought upon the ESA Guidelines by their rule-like design.\textsuperscript{195}

However, the acknowledgement of an “exceptional case” by a

\textsuperscript{192} Jürgen Bürkle, \textit{Auswirkungen von EIOPA-Leitlinien auf die Compliance in Versicherungsunternehmen}, 13 \textit{VERSICHERUNGSMORECHT} [VERSIR] 529 passim (2014) (Ger.).

\textsuperscript{193} See, e.g., Di Noia & Gargantini, \textit{supra} note 136, at 47 (“De lege lata, a similar result could be achieved by framing guidelines and recommendations so as to explicitly provide for some margins of monitored variance regarding specific contentious issues, and by calibrating supervisory measures in a flexible manner.”).

\textsuperscript{194} This line of precedent originated in the field of European antitrust law. See, e.g., Case C-226/11, Expedia Inc. v. Autorité de la concurrence and Others, 2012 EUR-Lex CELEX LEXIS 795; Case C-439/11 P, Ziegler S.A. v. Comm’n, 2013 EUR-Lex CELEX LEXIS 513; Case C-189/02 P et. al., Dansk Rerindustri v. Comm’n, 2005 ECR I-5488 ¶ 209 (concerning state aid law). Sources of the indirect legal relevance of the Commission’s nonbinding administrative publications are the principle of equal treatment and the protection of legitimate expectations. See SENDEN, \textit{supra} note 132, at 401 (providing an instructive discussion). Whether this precedent is applicable to the ESA is still an open question and has not yet been decided by the ECJ.

\textsuperscript{195} See \textit{supra} note 156.
national authority will by definition remain the exception. Furthermore, such acknowledgement will require a significant persuasive effort by the market participant. If the Guidelines impose costly interpretations of binding requirements, they will be intensively scrutinized and possible alternatives will be subject to a detailed examination. Market participants will analyze the underlying legal requirements and search for a more efficient, individual solution. Subjectivity in this regard does not only lead to change in an organization but also to an intensive internal dialogue in the organization that might result in a higher compliance rate and an overall higher efficiency of the regulation.

This “exemption clause” for exceptional cases should be stated in the ESA Regulations or the Guidelines. A single instance of noncompliance should not qualify a national supervisory authority as noncompliant under the ESA Regulations, and therefore should not be subject to the name-and-shame mechanism. However, in order to ensure that the “exemption clause” is not abused by Member States to conceal serious noncompliance, the supervisory authority should be obliged to explain its deviation to the ESA and give the reasons for its application of the exemption clause. In such cases a sufficient explanation would not lead to publication. On the other hand, if a Member State authority cannot sufficiently explain its deviation, noncompliance should be assessed by the Board of Supervisors and published. National transposition of the ESA Guidelines by law—individual enactment of Guidelines as well as enforcement duties laid down by national law—should also embody such an “exemption clause.”

B. Intended Effects According to Article 263 of the TFEU

Another important concern of commentators discussing the ESA Guidelines is the question of judicial review. European coherence, as well as the transformative effects of administrative enforcement, point in favor of direct European contestability of the ESA Guidelines. European law, however, does not allow for this.196 The literature has tried to establish certain indirect legal effects, drawing from case law like Grimaldi197 and from the binding implications that Guidelines may

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196. Guidelines are nonbinding by definition, and the Court of Justice of the European Union may only review acts “intended to produce legal effects.” TFEU art. 263.

197. See Case C-322/88, Grimaldi v. Fonds des maladies professionnelles, 1989 E.C.R. 4416, ¶ 18 (“The national courts are bound to take recommendations into consideration in order to decide disputes submitted to them, in particular where they cast light on the interpretation of national measures adopted in order to implement them or where they are designed to supplement binding Community provisions.”); see also Case C-207/01, Altair Chimica SpA, 2003 E.C.R. I-8894, ¶ 41 (affirming the Grimaldi decision); Case C-55/06,
cause together with the principle of equal treatment and the protection of legitimate expectations. But it is highly uncertain that the CJEU will accept such indirect legal consequences as sufficient, which until now have only been assigned to the ESA Guidelines by academia. Legal cognizability on these grounds would open the way for judicial review not only of the ESA Guidelines but also of all other soft-law instruments that are published by European institutions.

It therefore might be more expedient to study existing case law. In a certain line of precedents the ECJ has accepted for judicial review soft-law instruments of the Commission as "an act intended to have legal effects of its own." Even though this wording is similar to that of Article 263 of the TFEU, the meaning given to it by the ECJ could not be more different. Here, the ECJ held that it was sufficient for a "legal effect" that the measure went beyond already existing legal requirements. According to this argument, a mere interpretation of legal requirements does not constitute a legal effect. If, however, the Commission did not only explain the current legal regime but rather added certain substantive elements to it, the ECJ held that the Commission intended to bring about legal effects. Of no relevance whatsoever was the fact that the Commission did not have the legal power to change the relevant law. The European General Court ruled that, even if the Commission expressly called the measures "not binding," legal effects could have been intended. "Accordingly, the mere fact that, as the Commission contends, an interpretative communication does not – by its form, its nature or its wording – purport to be a measure intended to produce legal effects is not enough to support the conclusion that it does not produce binding legal effects." This line of precedent, however, is limited to rather narrow exceptions. It is unlikely

Arcor AG & Co. v. Deutsche Telekom, 2008 E.C.R. I-2976. However, this line of precedent was established in regard to recommendations by the Commission, the initial drafting institution of almost all European acts. It is not certain that it can also be applied to the ESA-Guidelines. Some scholars are of this opinion and furthermore state that these indirect legal effects are sufficient to establish "legal effects" within the meaning of Article 263 of the TFEU. See Inga Kawka, Comment, Commission Guidelines on Market Analysis and the Assessment of Significant Market Power Do Not Impose Obligations on Individuals, 2012 Y.B. ANTITRUST REG. STUD. 275, 279–80 (2012).

198. See supra note 193. This line of precedent is more likely to be applied to the ESA, although the ECJ has not yet acknowledged such indirect legal effects as sufficient, relying instead on direct, original legal effects. TFEU art. 263.


200. Id.

201. Id.

that it will lead to the contestability of all ESA Guidelines, but in rare circumstances cognizability might be established. Guidelines that significantly deviate from the wording of the European law could be interpreted as being "intended to have legal effects of its own." An action for review by private parties should be cognizable under such circumstances.203

C. Preponderant Industry Influence

By far the most difficult question is how to counter preponderant industry influence. Industry input is unquestionably indispensable for an efficient regulation of financial markets. A certain degree of industry influence in the Guideline-drafting procedures is therefore necessary and welcome. However, it will prove impossible to exactly locate the line that separates due from undue influence. Only extreme aberrations can be identified. Structural advantages such as dominance in stakeholder committees, or exclusive stakeholder representation when it comes to vital regulations such as Solvency II, come close to crossing this line. Such preponderant influence is, however, easy to mitigate. Industry stakeholders could, for instance, be granted fewer seats in the Stakeholder Groups. A more radical approach would be to deny industry

203. Such cognizability would require further action by the European legislature. According to Article 263, only Member States and the Parliament, Commission, Council, and Central Bank may bring an action without meeting further requirements. See TFEU art. 263. Natural or legal persons, however, need to be directly and individually concerned by the acts without further implementation measures. Id. This standard is hard to meet for most private entities.

A meaningful judicial-review regime would therefore need an extension by a special review procedure as had been put in place under Art. 230 EC for binding agency actions. Treaty Establishing the European Community art. 230, Dec. 24, 2002, 2002 O.J. (C 325) 126. Readers familiar with European law might object and cite the very restricted possibilities for natural and legal persons to bring an action for annulment against a directive. In general, only Member States and European institutions are entitled to contest a directive. Only they are addressed by directives, as only Member State authorities are addressed by Guidelines. Why then should ESA-Guidelines be treated differently? The answer lies in the special transposition system induced by directives. A European directive is supposed to only lay down certain fundamental provisions and to be transposed into national law by the national legislature, which in most instances will add certain requirements and compile an independent transposition law. Therefore, even though in most instances the core principles of a directive are part of a transposition law, it still is a genuine Member State law. In contrast to directives, ESA-Guidelines are not transposed into Member State law by a legislative process. They remain European soft law that is applied by the Member State authorities. Thus, the ESA Regulations should establish an internal European review procedure, which enables natural and legal persons to bring an action of annulment against such Guidelines as are "intended to have legal effects of their own."
representatives membership in the Groups altogether. Industry seems sufficiently represented in the open and public consultation process. Furthermore, most ESAs have established standing committees as subcommittees of the Board of Supervisors, which are also said to be dominated by industry representatives. However, such measures will not ensure a reduction of industry interest. Rather, it is likely that they will cause a shift of the influence-channels toward a more opaque system. It seems more important to ensure that a balanced proportion of equally influential stakeholders is selected to serve on the Stakeholder Groups.

If an exclusion of the most dominant interest group will not lead to a more balanced input, a strengthening of weaker interest groups might do so. Scholars have suggested that certain financial and organizational assistance could bolster meaningful nonindustry representative participation. Within the ESAs, a meaningful contribution to this goal would be to raise the financial support that nonindustry stakeholders, such as consumers and end-users, receive to enable their participation. Furthermore, administrative support could be granted and staff could be provided to support the civil society representatives to cope with the extensive workload of the Stakeholder Groups. This could enable representatives of organizations with rather scarce resources to contribute more meaningful input. However, even if such measures were adopted, civil society input would be mostly limited to consumer-protection questions. It has been observed that important structural questions with no direct consumer implications seem not to be dealt with by consumer representatives. This touches on an important issue: consumer representatives are not the equivalent of civil society. The Stakeholder Groups are not meant to be the substitute for an absent legislative procedure. Even if consumer representatives might be close to the “average citizen” (since all citizens are consumers), they are not representative of the European Union citizen. Their representation focuses on consumer-protection matters to the exclusion of other issues. Those other issues might be of great relevance to the general public but do not carry direct consumer implications. However, this leads to a systematic shortfall of nonindustry input in certain cases, which becomes even more worrisome against the background of the important

204. See IGLESIAS-RODRIGUEZ, supra note 100, at 267-68.
role ESA Guidelines have been given.

The question of how to mitigate the lack of participation from civil society in vital Guideline-drafting procedures is a difficult one. To ensure a reasonable level of legitimacy and at the same time leave an effective regime of Guidelines intact, it seems most suitable to limit an additional path of influence to interest representation and observation. For example, a procedure that entails the requirement of the responsible ESA staff to brief a member of the relevant parliamentary committee during the various stages of the drafting process could be established. This would ensure that the views of the European citizens' representative, who in most cases will have been deeply involved in the drafting process of the underlying European law, are made known to the ESA. Furthermore, it could also serve as a "policing" tool206 of the European Parliament, which in turn could use ESAs' reporting duties,207 parliamentary budget powers,208 and its legislative powers to push for its view.

CONCLUSION

As a result of the financial crisis, the European Union has implemented a more coherent and harmonized approach to financial regulation. As the main actors in this undertaking, each ESA has been equipped with certain regulatory tools, of which the ESA Guidelines are the most extraordinary. Their soft-law character resembles global coordination tools like those of the Basel Committee. However, even though the Basel Committee and the ESAs share certain characteristics, the deep legal embedding of the ESAs in European and national law gives its soft-law instruments their distinctive character.

As an integral part of the European regulatory process, the enforcement-coordinating ESA Guidelines are not only likely to be strictly followed by Member State authorities, but will also turn into hard-law requirements via their enforcement powers. While underenforcement does not seem to be an issue, the ESA Guidelines' soft-law nature leads to two different problems. First, soft law does not need a legislative mandate and can be issued so long as it retains a certain connection to the underlying hard law. Second, soft law is not subject to the sophisticated legislative procedures that are supposed to

206. See generally Mathew D. McCubbins & Thomas Schwartz, Congressional Oversight Overlooked: Police Patrols Versus Fire Alarms, 28 AM. J. POL. SCI. 165 (1984) (providing an introduction to the concept of agency control via "policing" and "fire alarms").
207. ESA Regulations, supra note 5, at art. 43 ¶ 5.
208. ESA Regulations, supra note 3, at art. 62. The budget is part of the general budget of the Union, subject to a vote by Parliament and Council. TFEU art. 314.
prevent undue influence and establish a regulatory compromise. This leads to a setting in which ESA Guidelines can be issued on crucial subjects without proper safeguards against preponderant industry influence. However, the European legislature had to resort to a soft-law instrument because of restrictive European law. In the specific setting of the Lamfalussy procedure, this lead not only to a flexible and efficient design but also to a two-level mechanism, by which Guidelines in combination with their underlying principles seem to combine the benefits of rules-based and principles-based regulatory techniques.

This leaves us with a number of problems *de lege lata*. The compliance mechanism at the European level might prove too effective, hardening the soft ESA Guidelines to an extent that annihilates the benefits of its mixed character. Furthermore, the lack of judicial accountability at the European level seems to run contrary to the wide-ranging effects and the harmonizing goal of the Guidelines. Finally, a preponderant industry interest might reduce the overall legitimacy of the Guidelines. All of these deficiencies gain in importance from a subjectivity perspective. However, most of them could be solved by rather limited adjustments to the respective European administrative law.