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– In the Name of the Integration –

THE REFORM OF FINANCIAL SUPERVISORY SYSTEM OF THE EUROPEAN UNION

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(*Abstract*) In 2007 the greatest economic crisis of the economic system based on the principles of capitalism has began, since the "Great Depression". The last quarter of the 20th century clearly permeated by the globalization of the financial market and at the same time the processes toward its deregulation and liberalization. As a consequence of these developments the financial sector – because its display for speculation – has drawn away the real economy and overbalanced the stability of the entire economic system. The globalization and technological development almost completely dismantled the state boundaries facing with the financial market and the deregulation seriously dented the possibilities of state's intervention. In these circumstances, the European Union has reacted very quickly to the economic crisis and both the tools and the organizational system of the European supervisory system over the financial market brought under complete revision. The study aims to provide an overview of the EU's financial supervision system reform, particularly with regard to the judicial protection of the reform's achievements.

Keywords: Banking Union, ESMA, European supervisory agencies, financial market, prudential supervision.

JEL Classification: G18, G20, G28, K23, P48.

Outline of Article

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1. Introduction

Since the "Great Depression", the greatest crisis based on the principles of capitalism started in 2007. The last quarter of the 21st century was undoubtedly encompassed by the financial markets' globalisation and at the same times its deregulation and liberalisation.[1] As their result, the financial market diverged from the real

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[1] *See* for more details: STIGLITZ, Joseph E.: *A globalizáció és visszásságai*, 2003, Napvilág Kiadó, Budapest.

economy and because of its inclination to speculation; it overthrew the stability of the whole economic system.[2] Globalisation and technical improvement almost completely demolished the state borders standing in front of the financial market's processes, while deregulation seriously manhandled the possibilities of state intervention. Taking these circumstances into consideration, the European Union responded to the development of the economic crisis and completely revised the regulation of the financial market and the tool- and organization system of its supervision. These processes undoubtedly point towards the direction of stronger economic integration, hence, in the frame of this study I only endeavour to survey the European supervisory architecture formed as the reform of the European financial supervisory system, in two stages. For the first sight, this architecture only seems to be the further integration of the internal market, however, if we investigate the institutional reforms more closely, discussing the legality of certain competences means that serious legal changes were formed under the surface. Of course, the most important question is whether these changes remained in frames of the founding treaties or not. Considering this, in the second part of the study I will investigate the supervisory reform's effect on the European Union's legal system and the Court of Justice of the European Union's (hereinafter: ECJ) legal interpretation which protects integration.

2. Reform of the European Union's financial supervisory system – first step

The painful experience of the economic crisis made the European decision-makers learn from the failures of regulation and make the necessary new rules. One of the most important experiences of the crisis was that focusing financial market's supervision on individual, institutional risks is not enough; the supervisory system has to be completed with the monitoring of macro-prudential (systemic) risks, too. Furthermore, the number of financial institutions providing cross-border services has significantly increased in the last three decades in the European Union, possessing the ability to cause *negative externalities* all over Europe. It became obvious that the fragmented European supervisory system resting on national supervision – in which no coordination mechanism operated before 2009 – was inappropriate for the notification and handling of cross-border risks.[3] As the *Turner review*[4] also highlights, macro-prudential analyses were done by many various authorities on various levels without such mechanisms which could convert risk alerts to decision-making. Hence, the crisis called the attention to the strengthening of the European Union's ability of crisis prevention and crisis management.[5] Considering this, the European Commission asked a highly professional group with the lead of *Jacques de Larosiére*, previous Managing Director of the International Monetary Foundation (IMF), to make proposals for creating a more effective, integrated and maintainable supervisory frame.

The so called "*wise men*" published their proposals at the beginning of 2009.[6] The excessive document gives a comprehensive analysis of the financial crisis' reasons and summarizes the – *short- and long-term* – tasks in a proposal of almost 31 points which are definitely needed to be noticed not only by Europe but the world leaders, too. The Larosiére Report projected the European financial supervisory system's outlines, supporting it with professional reasons.[7]

Based on the Larosiére Report, the Commission published a communication in May 2009, in which it introduced the supervisory reform package,[8] then, on 23rd September, it published the new supervisory system's draft legislation. The Commission prepared the draft of regulations forming the authorities based on wide, public professional debate. The ECOFIN approved the draft on 2nd December 2009 and it was accepted by the Council on 7th September 2010, then by the European Parliament on 21st September. Hence, the new financial supervisory architecture started its operation on 1st January 2011.

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[2] *See* GÁL, Zoltán: *Pénzügyi piacok a globális térben*, 2010, Akadémiai Kiadó, Budapest, 105-108.
[3] HENNESSY, Alexandra: Redesigning financial supervision in the European Union (2009-2013), in *Journal of European Public Policy*, Vol. 21. No. 2. (2013) 155.
[4] *The Turner Review* (March 2009), http://www.fsa.gov.uk/pubs/other/turner_review.pdf (2014.07.21.).
[5] WOUTERS, Jan – KERSCKHOVEN, Sven Van: The EU's Internal and External Regulatory Actions after the Outbreak of the 2008 Financial Crisis, in *Leuven Centre for Global Governance Studies Working Paper* No. 69., http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1898680 (2014.07.21.) 7.
[6] *The High Level Group on Financial Supervision is the EU: De Larosiere Report*, http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf (2014.07.21.).
[7] This system – according to *Forgács* – is clearly strengthens the European institutional structure's federal character. *See* FORGÁCS, Imre: *Mégsem éjjeliőr? Az európai kormányzás esélyei és a pénzügyi válság*. 2009, Osiris Kiadó – Zrínyi Kiadó, Budapest, 344.
[8] Communication from the Commission – European financial supervision, COM (2009) 252.

2.1. The European System of Financial Supervisors – survey

In frames of the European Union's financial supervisory system's reform, the *European System of Financial Supervisors* (hereinafter: ESFS) was established, which is built on a macro- and a micro-prudential pillar. As for the European Union, these two pillars – based on the legal nature of the applicable competences – serve different aims. The macro-prudential pillar aims at the *stability* of the European Union's financial system with soft law like, legally not binding competences, while the micro-prudential pillar points into the direction of further *integration* through legally binding decision-making competences.

The *European Systemic Risk Board* (hereinafter: ESRB)[9] was formed as a macro-prudential pillar, which – according to Larosiére's report – was organized as a special organisational unit of the European Central Bank.[10] Furthermore, the *European Supervisory Authorities*' (hereinafter: ESA or ESAs) system was formed, which is a robust network of national financial supervisors working in tandem with new ESAs to safeguard financial soundness at the level of individual financial firms and protect consumers of financial service, namely, to realize micro-prudential supervision. This micro-prudential pillar's elements are: 1.) *European Banking Authority* (hereinafter: EBA);[11] 2.) *European Insurance and Occupational Pensions Authority* (hereinafter: EIOPA);[12] 3.) *European Securities and Markets Authority* (hereinafter: ESMA);[13] 4.) the *Joint Committee* of the ESAs and 5.) the competent or supervisory authorities as specified in the Union acts,[14] furthermore *the European Central Bank with regards to the single supervisory mechanism*.

The ESFS – which based on the Larosiére report – was only the first step in the course of the reform of the European Union's financial supervisory system. Considering the regulations of the European Union's legal system – as I am going to elaborate on it later – it was not yet the centralization of supervisory competences to European level, as on the one hand – as we will see it –, the ESRB cannot make legally binding decisions, on the other hand, ESAs do not carry out direct European Union supervision – *as a main rule* – over the financial market's institutions, their main task is the "supervision" of member state supervisory authorities. One general and one special exception can be highlighted from this statement. ESMA's competence regarding credit rating agencies is a general exception, as ESMA carries out these institutions' direct supervision. As a special exception, ESAs – as I am going to discuss about it later – can carry out direct supervisory competences over financial market participants in three cases, in case of meeting determined conditions.

Henceforward, I am going to review the organizational system and the most important competences of macro- and micro-prudential pillars, followed by the second step of the reform of the European Union's supervisory system, the Banking Union.

2.2. The micro-prudential pillar: The European Systemic Risk Board

The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union that arise from developments within the financial system and taking into account macroeconomic

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[9] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (hereinafter: ESRB Reg.).

[10] Macro-prudential supervision is the analysis of trends and imbalances in the financial system and the detection of systemic risks that these trends may pose to financial institutions and the economy. The focus of macro-prudential supervision is the safety of the financial and economic system as a whole, the preventionof systemic risk. *See* HOUSE OF LORDS, *The future of EU financial regulation and supervision*, Volume I: Report, 2009, http://www.publications.parliament.uk/pa/ld200809/ldselect/ldeucom/106/106i.pdf (2014.07.21.). 12.

[11] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (hereinafter: EBA Reg.).

[12] Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC (hereinafter: EOIPA Reg.).

[13] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (hereinafter: ESMA Reg., the three regulation together hereinafter: ESA Reg.).

[14] In Hungary the only competent authority is the Hungarian National Bank.

developments, so as to avoid periods of widespread financial distress. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.[15]

The ESRB was formed based on *Article 114* of the Treaty on the Functioning of the European Union (hereinafter: TFEU) as a body lacking legal personality and legal competences, hence, it cannot be regarded as a European agency but is rather a so called *soft law organisation*.[16] According to the ideal, it was formed as a high level "reputational" body, with a high level composition that should influence the actions of policy makers and supervisors by means of its moral authority. "Prior to this, it must be ensured that the set-up, staff and proceedings of the ESRB are such as to instil confidence in its ability to (a) make independent judgements, (b) produce high-quality analysis and (c) reach "sharp" conclusions."[17]

The ESRB can be best placed in the European Union's institutional system via connecting it to ECB, as its secretariat tasks are carried out by ECB, who basically provides a basic operational assistance for ESRB, furthermore, its General Board's members are given by the governors of central banks and its chair is the president of ECB. Based on these, ESRB can be regarded as ECB's "*organizational unit*" with special competence and legal status.

2.2.1. The organization of the European Systemic Risk Board

Regarding its organization, ESRB consists of a) General Board, b) Steering Committee, c) Secretariat, d) Advisory Scientific Committee and e) Advisory Technical Committee.

The *General Board* is the ESRB's main decision-making body, as this body makes decisions necessary for the carrying out of those tasks which ESRB is entrusted with.[18] The *General Board* has 67 members, out of which 38 has right to vote. In the *General Board*: the President (1) and Vice-President of ECB (1), Governors of the national central banks (28), one member of the European Commission (1), the Chairpersons of the three European Supervisory Authorities (3), the Chair and the two Vice-Chairs of the Advisory Scientific Committee (3) the Chair of the Advisory Technical Committee has right to vote. Its members without right to vote are: one high-level representative per Member State of the competent national supervisory authorities, in accordance with paragraph 3 (28) and the President of the Economic and Financial Committee (1). The ESRB's first *chair* is held by the president of ECB in the first five years.[19] Besides the Chair, the organization also has two Vice-Chairs: the first Vice-Chair is elected by and from the members of the General Council of the ECB for a term of 5 years; the second Vice-Chair is the Chair of the Joint Committee.

The *Steering Committee* assist in the decision-making process of the ESRB by preparing the meetings of the General Board, reviewing the documents to be discussed and monitoring the progress of the ESRB's ongoing work.[20] Similarly to the General Boards, this organizational unit also has a large membership, its members are: the Chair and first Vice-Chair of the ESRB, the Vice-President of the ECB, four other members of the General Board, a Member of the European Commission, the Chairpersons of three ESAs, the President of the EFC, the Chair of the Advisory Scientific Committee and the Chair of the Advisory Technical Committee.

The *Secretariat* is responsible for the day-to-day business of the ESRB. The secretariat – as I have already mentioned – is ensured by the ECB, hence, it provides analytical, statistical, logistic and

[15] ESRB Reg. Art. 3 para. 1.
[16] VERHELST, Stijn: Renewen Financial Supervision in Europe – Final or Transitory? in *Egmont Paper* 44. 2011. 29.
[17] GOLDBY, Miriam – KELLER, Anat: The Commission's proposal for a new European Systemic Risk Board: an evolution, in *Law and Financial Market Review*, Vol. 4. No. 1. (2010) 51.
[18] ESRB Reg. Art. 4 para. 2.
[19] ESRB Reg. Art. 5 para. 1. However, it is important to note that the ESAs regulations made the way of the chair election an objective of a later political negotiation. The regulations states that for the subsequent terms, the Chair of the ESRB shall be designated in accordance with the modalities determined on the basis of the review provided for in Article 20. As part of the ESRB's review process the Directorate General for Internal Policies made some recommendations to the European legislator. One of their recommendations refers to the Chair of the ESRB and states that the appointment of an independent, dedicated, Chair would strengthen the ESRB's profile and independence. The Chair should be an individual of high standing, for instance a former Central Bank Governor or the former Head of a National Supervisory Authority. *See Review of the New European System of Financial Supervision. Part 2: The Work of the European Systemic Risk Board*, IP/A/ECON/ST/2012-23, 2013. 86.
[20] ESRB Reg. Art. 4 para. 3.

administrative support for the ESRB.[21] The *Advisory Scientific Committee* provides scientific support, while the *Advisory Technical Committee* – for the request of the ESRB's Chair – provides professional advice and support for the fulfilment of ESRB's tasks.

2.2.2. Task- and competences of the European Systemic Risk Boards

Besides determining and/or collecting, analysing all the relevant and necessary information, ESRB's tasks among others include identifying and prioritising systemic risks, carrying out and in given cases, issuing recommendations aiming at correctional measures referring to already identified risks, issuing warnings and monitoring the follow-up to warnings and recommendations. Cooperating with ESAs, ESRB's task is to develop a common set of quantitative and qualitative indicators to identify and measure systemic risks (*risk dashboard*).[22] According to the wish of European legislators – as shown from the tasks as well –, ESRB is more than a simple warning system.[23]

Warning and recommendation must be highlighted from ESRB's competences, which two can be either a general or a specific nature and can be addressed in particular to the Union as a whole or to one or more Member States, or to one or more of the ESAs, or to one or more of the national supervisory authorities, however, it is significant to note that market actors are excluded. Recommendations may also be addressed to the Commission in respect of the relevant Union legislation. ESRB's recommendations are not legally binding for their addressees, but the ESRB regulation introduces the "*act or explain*"[24] and – familiar from the practice of OECD – "*naming and shaming*"[25] mechanism[26] aiming at recommendations' compliance. These mechanisms serve the aim that addressees keep themselves to the recommendations, if not; they have to provide reasons for deviating from them (in certain cases in front of public).[27]

2.3. The micro-prudential pillar: European Supervisory Authorities

As ESFS' micro-prudential pillar, the so called *Lámfalussy committees,* which had already existed in the EU, were replaced as European authorities (agencies).[28] The ESAs are the most important and innovative elements of the ESFS. ESAs responsibility has significantly increased, and received defined, legally binding

[21] Council Regulation (EU) No 1096/2010 of 17 November 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board**,** Art. 2 para. 1.
[22] ESRB Reg. Art. 3 para. 2. *See* also the ESRB Handbook, http://www.esrb.europa.eu/pub/pdf/other/140303_esrb_handbook.pdf?0b3d9b0fdec83c29b3ab2e13f4ed494a (2014.07.21.).
[23] FORGÁCS, Imre: Európai Egyesült Államok – a pénzügyi jogban, in *Jogtudományi Közlöny*, Vol. 66. No. 7-8. (2011) 405-406.
[24] According to the ESRB Reg. *Art. 17 para. 1.* if a recommendation referred to in Article 3 (2) (d) is addressed to the Commission, to one or more Member States, to one or more ESAs, or to one or more national supervisory authorities, the addressees shall communicate to the ESRB and to the Council the actions undertaken in response to the recommendation and shall provide adequate justification for any inaction. Where relevant, the ESRB shall, subject to strict rules of confidentiality, inform the ESAs without delay of the answers received.
[25] According to the ESRB Reg. *Art. 18 para. 1.* the General Board shall decide on a case-by-case basis, after having informed the Council sufficiently in advance so that it is able to react, whether a warning or a recommendation should be made public. Notwithstanding Article 10 (3), a quorum of two-thirds shall always apply to decisions taken by the General Board under this paragraph. About the working of the „naming and shaming" mechanism *see* PFAELTZER, Juliette J. W.: Naming and shaming in financial market regulations: A violation of the presumption of innocence? in *Utrecht Law Review*, Vol. 10. No. 1. (2014) 134-148.
[26] „Its lack of direct enforcement powers is a key difference with respect to the arrangement in the United States, where the new macro-prudential body, the Financial Stability Oversight Council (FSOC), is assigned direct intervention tools, including at the micro level." *See* VISCO, Ignazio: Key issues for the success of macro-prudential policies, in *BIS Papers* No. 60. (2011) 2.
[27] FERRAN, Eilís – ALEXANDER, Kern: Can soft law bodies be effective? Soft systemic risk oversight bodies and the special case of the European System Risk Board, in *University of Cambridge Faculty of Law Research Paper* No. 36/2011. 30-31. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1676140 (2014.07.21.).
[28] The so called Lámfalussy process – because of length barrier – is not the object of this studies further analysis. For more details, *see* ALFORD, Duncan: The Lamfalussy Process and EU Bank Regulation: Another Step on the Road to Pan-European Bank Regulation? in *Annual Review of Banking & Finance Law*, Vol. 25. (2006) 389-435.; MOELLERS, Thomas M.J.: Sources of Law in European Securities Regulation - Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to Larosière, in *European Business Organization Law Review*, Vol. 11. No. 3. (2010) 379-407.

tools, greater autonomy and widened competence as the result of the reform,[29] with which simultaneously a move happened towards the direction of advancing the financial market's supervision to European Union level.

2.3.1. The organization of the European Supervisory Authorities

The ESAs are Union bodies with legal personality. In each Member State, the ESAs enjoy the most extensive legal capacity accorded to legal persons under national law. As for their organisational structure, ESAs comprise a(n): a) *Board of Supervisors*, b) *Management Board*, c) *Chairperson*, d) *Executive Director*. The e) *Joint Committee* and f) *Board of Appeal* operates as a common unit of the ESAs, furthermore, inside the organization of the ESAs in an institutionalized form g) *Stakeholder Groups* were formed, too.

The *Board of Supervisors* (hereinafter: BoS) is the ESA's main decision-making body, which members having right to vote are the heads of the national public authority competent for the supervision of financial market participants in each Member State. From this point of view, the BoS can be regarded as an intergovernmental body as every member state is represented in it; however, it makes decisions according to main rule with simple majority of its members.

The BoS – because of its large membership – is not suitable for the organizations' operating operation, hence, preparing meetings, presenting proposals and making other personal policy decisions belong to the competence of the *Management Board*. The *Management Board* composed of the Chairperson and six other members of the BoS, elected by and from the voting members of the BoS. The *Management Board* ensure that the ESA carries out its mission and performs the tasks assigned to it in accordance with this Regulation.

The ESA is represented by the *Chairperson*, who is a full-time independent professional. The Chairperson is appointed by the BoS on the basis of merit, skills, knowledge of financial market participants and markets, and of experience relevant to financial supervision and regulation, following an open selection procedure. The Chairperson is responsible for preparing the work of the BoS' and chairs the meetings of the BoS and the Management Board. The ESA is managed by an *Executive Director*, who is a full-time independent professional.

The ESAs have two common bodies: the *Joint Committee* and the *Board of Appeal*. The *Joint Committee* serve as a forum in which the ESAs shall cooperate regularly and closely and ensure cross-sectoral consistency with the ESAs. The *Board of Appeal* which carrying out legal remedy function is also a common body of the three ESAs. The Board of Appeal composed of six members and six substitute members, who are highly-appreciated people and have justified professional knowledge and professional experience.

From consumer protection point of view, the formation of various *Stakeholder Groups* in ESA's organization is a significant step forward, as they can involve stakeholder groups in the decision making process through this. They can be part of the decision making process[30] officially and in an institutionalized form and they may decrease the democratic deficit shown in the Union's operation.

2.3.2. Tasks and competences of the European Supervisory Authorities

The ESAs aim at protecting the common interest for the sake of the EU's economy, citizens and businesses through contributing to the financial system's stability and effectiveness.[31] Taking this into consideration, European legislators determined common and sector specific tasks for ESAs. With relation to the financial sector belonging to its competence, every authority has to contribute to the establishment of high- quality common regulatory and supervisory standards and practices. Sector specific tasks are determined by the ESA regulations and other legal acts, for instance, the authorization of credit rating agencies and their direct European level supervision belongs to the task and competence sphere of ESMA. It is important to highlight that this competence of the ESMA, for the first time overwrote the basic principle – *the principle of home country supervision* – of the European integration's financial supervisory structure via centralizing supervisory competences on Union level.

The ESAs competences – based on the competences' legal nature – can be put into two great groups: 1.)

[29] RODRIGUEZ, Pablo Iglesias: Towards a new european financial supervision architecture, in *Columbia Journal of European Law Online,* 2009/1. 3. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1518062 (2014.07.21.); KREISZ, Brigitta: A pénzügyi felügyelet igazgatási struktúráinak fejlődése a gazdasági kormányzás megújuló európai koncepciója tükrében, in *De iurisprudentia et iure publico*, Vol. 7. No. 3. (2012) 6.

[30] EMMENEGGER, Susan: Procedural Consumer Protection and Financial Market Supervision, in *EUI Working Papers Law* No. 2010/05. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1616322 (2014.07.21.).

[31] SOÓS, János: Az új európai pénzügyi felügyeleti struktúra, in *Európai Tükör*, Vol. 16. No. 2. (2011) 133.

quasi regulative competences and 2.) *supervisory competences*.

The ESA regulations delegated the competence to develop legally binding (draft) *regulatory technical standards and implementing technical standards* and the working out of soft law like *recommendations and guidelines* to the ESAs. In short, we can call these competences as ESAs *quasi regulative competences* as in the case of standards, only elaboration belongs to the ESA's competence, while the Commission decides on their endorsement, as for recommendations and guidelines, they are not legally binding, anyway. "*Quasi*" nature comes from this, as the ESAs do not practice actual regulative competences.[32]

In order to protect public values – which the market itself cannot guarantee –, regulation does not prove to be sufficient.[33] "It is also necessary to verify their actual application by market participants and, in case of non-compliance, to enforce them".[34] This is the basic aim and explanation of supervisory competences. I have to note that there are authors arguing besides that *in practice, supervision matters more than regulation*.[35] The supervision of system of rules referring to the European Union's financial market – before the start of the reform process – was carried out by member state supervisory authorities, which – as I have previously mentioned it – could not keep track with the integration of the financial market and the handling of cross-border activities and risks. The Larosiére report noticed the basic problem, however, in the first step of the reform – with the formation of ESFS – only the most significant direct supervisory competences were risen to European Union level. The ESAs supervisory competences primarily aim at the supervision of member state supervisory authorities' activity, and only secondly, in final state at the financial market participants.

The ESAs supervisory competences can be overlooked via putting them into three groups: 1.) *micro-prudential supervisory competences*; 2.) *macro-prudential supervisory competences*, and 3.) *law enforcement competences*.

Among *micro-prudential supervisory competences (1)* the ESAs contribute to promoting and monitoring the efficient, effective and consistent functioning of the colleges of supervisors established in the legislative acts and foster the coherence of the application of Union law among the colleges of supervisors.[36] *(2)* the ESAs fulfil a general coordination role between competent authorities, in particular in situations where adverse developments could potentially jeopardise the orderly functioning and integrity of financial markets or the stability of the financial system in the Union.[37] *(3)* the ESAs periodically organise and conduct peer reviews of some or all of the activities of competent authorities, to further strengthen consistency in supervisory outcome [38] *(4)* the ESAs monitor and assess market developments in the area of its competence and, where necessary, inform the other ESAs, the ESRB and the European Parliament, the Council and the Commission about the relevant micro-prudential trends, potential risks and vulnerabilities.[39] Finally, *(5)* the ESAs play an active role in building a common Union supervisory culture and consistent supervisory practices, as well as in ensuring uniform procedures and consistent approaches throughout the Union. [40]

Based on the institutional structure, ESRB's efficient operation is greatly dependent on its cooperation with ESAs, as adequate information is needed for carrying out macro-prudential supervision (*competences connected to macro-prudential supervision*).[41] *(1)* The ESAs, in collaboration with the ESRB, develop a common approach for the identification and measurement of systemic risk posed by key financial market

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[32] *See* for more details: MOLONEY, Niamh: The European Securities and Markets Authority and Institutuonal Design for the EU Financial Market – A Tale of Two Competences: Part (1) Rule-Making, in *European Business Organization Law Review*, Vol. 12. No. 1. (2011).

[33] The market failures, from the assimetric information to the negative externality, are widely known in the scientific literature. *See* for more details: DE HAAN, Jakob – OOSTERLOO, Sander – SCHOENMAKER, Dirk: *European Financial Markets and Institutions.* 2009, Cambridge University Press, Cambridge, 300.; LAPSÁNSZKY, András: *A hírközlés közszolgáltatási-közigazgatási rendszerének fejlődése és szerkezeti reformja*. 2009, HVG-Orac, Budapest, 39.

[34] LEVI, Luca Martino: The European Banking Authority: Legal Framework, Operation and Challenges Ahead, in *Tulane European & Civil Law Forum*, Vol. 28. (2013) 73.

[35] AMBER, Tim – SALTIERL, Miles: *Bank Regulation: Can We Trust the Vickers Report?* Adam Smith Institute, 2011. http://www.adamsmith.org/sites/default/files/resources/banking-reform.pdf (2014.07.21.) 19.

[36] ESA Reg. Art. 21.

[37] ESA Reg. Art. 31.

[38] ESA Reg. Art. 30.

[39] ESA Reg. Art. 32.

[40] ESA Reg. Art. 29.

[41] *See* the ESRB Reg. 24. preamble point. It states that the participation of micro-prudential supervisors in the work of the ESRB is essential to ensure that the assessment of macro-prudential risk is based on complete and accurate information about developments in the financial system.

participants, including quantitative and qualitative indicators as appropriate. (*risk dashboard*).[42] (2) Besides this, the ESAs, in consultation with the ESRB, develop criteria for the identification and measurement of systemic risk and an adequate stress testing regime which includes an evaluation of the potential for systemic risk posed by financial market participants to increase in situations of stress.[43] (3) If needed, the ESAs draw up, as necessary, additional guidelines and recommendations for key financial market participants, to take account of the systemic risk posed by them.[44] (4) Upon a request from one or more competent authorities, the European Parliament, the Council or the Commission, or on its own initiative, the ESAs may conduct an inquiry into a particular type of financial activity or type of product or type of conduct in order to assess potential threats to the integrity of financial markets or the stability of the financial system and make appropriate recommendations for action to the competent authorities concerned.[45]

The ESAs most significant competences are the legally binding decisions serving as tools of *law enforcement*. These competences are the first ones to give the possibility for a Union body operational supervisory power over competent authorities and market participants.[46] I have to highlight that these competences' primary aim is the *"supervision of member state supervisory authorities"* and they only have the possibility to take obligatory decisions regarding the financial market participants in final cases. It is important to note that these decisions do not "overwrite" the decisions of member state supervisory authorities but – as characteristic of the EU law – they *enjoy direct effect,* as according to the wording of ESA regulations, *prevail over any previous decision adopted by the competent authorities on the same matter.*[47] Three types of decisions belong to this group: (1) in case of breach Union law,[48] (2) in actions in emergency situation[49] and (3) legally binding decisions made during the settlement of disagreements[50] between competent authorities in cross-border situations.[51]

The formation of ESFS can be regarded as an initial step of the financial "supervisory architecture" package[52] which was (one of) the European Union's responses to the economic crisis – based on the *Larosiére report*. Because of legal and political reasons, supervisory authorities formed in the first step among the frames of ESFS were only authorized with such competences which allow direct intervention into market activity as a "final solution".[53] However, tendencies pointing into the direction of more dynamic direct European-level supervision became clear with the formation of ESFS. The reform of the European Union's financial supervisory system continues with the second step, namely, the formation of direct European level supervision.

3. European Banking Union – the second step

As I have previously mentioned it, prudential regulation is currently based on regulations and directives of the European Union, the latter ones have to be implemented into member states' domestic legislation. However, the supervision of prudential rules only belongs to the competence of member states. This lead to member states' various practices, which is a serious obstacle regarding the complete realization of an internal market and the handling of possible risks.[54]

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[42] ESA Reg. Art. 22 para. 2.
[43] ESA Reg. Art. 23 para. 1.
[44] ESA Reg. Art. 22 para. 3.
[45] ESA Reg. Art. 22 para. 4.
[46] MOLONEY, Niamh: Reform or Revolution? The Financial Crisis, EU Financial Markets Law, and the European Securities Markets Authority, in *International and Comparative Law Quarterly*, Vol. 60. Issue 2. (2011) 532.
[47] ESA Reg. Art. 17 para. 7.; Art. 18 para. 5.; Art. 19 para. 5.
[48] ESA Reg. Art. 17.
[49] ESA Reg. Art. 18.
[50] ESA Reg. Art. 19.
[51] The further, detailed analyses of the tools of the law enforcement is not the subject of this study. About the tools *see* LEVI: op. cit.; MOLONEY, Niamh: The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part (2) Rules in Action, in *European Business Organization Law Review*, Vol. 12. No. 2. (2011).
[52] FAHELY, Elaine: Does the Emperor have financial crisis clothes? Reflections on the legal basis of the European Banking Authority, in *The Modern Law Review*, Vol. 74. No. 4. (2011) 581.
[53] FERRAN, Eilís: Understanding the new institutional architecture of EU financial market supervision, in *University of Cambridge Faculty of Law Research Paper,* No. 29/2011. 41. http://papers.ssrn. com/sol3/papers.cfm?a bstract_id= 1701147## (2014.07.21.).
[54] WYMEERSCH, Eddy: The European Banking Union, a first analysis, in *Financial Law Institute Working Paper Series*, 2012. 3. http://www.law.ugent.be/fli/wps/showwps.php?wpsid=250 (2014.07.21.).

The Banking Union's reform plan is the most important part of the European Commission's and the President of the European Council's recommendation package,[55] or political vision aiming at the realization of *"genuine economic and monetary union"* – from the point of view of financial markets (and the internal market).[56] The Banking Union – in contradiction with its name – is not the union of banks but practically an integrated financial framework which further consists of three sub-systems: a.) the *Single Supervisory Mechanism* (hereinafter: SSM), b.) the *Single Resolution Mechanism* (hereinafter: SRM) and c.) the *Common Deposit Guarantee Schemes* (hereinafter: CDGS).[57] These three pillars are completed with the so called *Single Rulebook* which aims to provide a single set of harmonised prudential rules which institutions throughout the EU must respect. So it is basically nothing else but a unified set of rules of the banking sector consisting of Union regulations, directives following maximum harmonization, regulatory- and implementing technical standards accepted by the Commission, prepared by the EBA. The SSM is going to start its operation in November 2014, while the members of the Banking Union have to implement SRM's rules into their domestic legislation until January 2015. Since the announcement of the concept of the Banking Union, nothing has happened in connection with CDGS.

According to the original concept of SSM, euro-zone member states' complete banking system would have gotten under the direct supervision of ECB.[58] This concept would have been completely unacceptable[59] for most member states (such as Germany, Finland) as according to their suggestion, bank supervisory competences could only get to Union level above (so called *systematically important financial institutions*) a certain determined size (assets). According to the compromise solution, ECB will directly supervise the *significant credit institutions*, which cover 85% of the Euro zone's whole bank assets. Before qualifying institutions as significant, ECB takes various concrete criteria into account (total value of assets; importance for the economy of the Union or any participating Member State; its significance of cross-border activities, etc.). However, it is significant that *at least, the three most significant credit institutions* of every participating country, regardless of their absolute size, fall under the supervision of ECB. The Article 6 paragraph 4 subparagraph 4 of SSM Reg. makes the system flexible, according to which *ECB* may also, *on its own initiative, consider an institution to be of significant relevance* where it has established banking subsidiaries in more than one participating Member States and its cross-border assets or liabilities represent a significant part of its total assets or liabilities subject to the conditions laid down in the methodology.

The SSM applies to countries which currency is the euro (Euro-zone member states), but other countries are also allowed to join. The SSM Reg. considers it *close cooperation*. However, it is not simply cooperation, but during the executions of ECB's task it is regarded as the participating countries' supervisory authority with all those competences which member state supervisory authorities possess based on the EU

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[55] *See Towards the Genuine Economic and Monetary Union* (Brussels, 26 June 2012). http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/134069.pdf (2014.07.21.).

[56] To achieve the genuine economic and monetary union, the Commission and the President of the European Council focus on three areas: 1.) the integrated financial framework, 2.) the integrated budgetary framework and 3.) the integrated economic policy framework. These integrated frameworks claim for the necessary democratic legitimacy and accountability of decision-making within the EMU, based on the joint exercise of sovereignty for common policies and solidarity.

[57] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (*hereinafter: SSM Reg*.); Regulation (EU) No 1022/2013 of the European Parliament and of the Council of 22 October 2013 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) No 1024/2013; Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (hereinafter: *SSM Framework Regulation*); Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 (hereinafter: *SRM Reg*.); Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (hereinafter: *SRM Dir.*).

[58] *See* COM (2012) 511 Proposal for a Council Regulation conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (hereinafter: Proposal).

[59] Some experts were also against of the total integration. *See* LANNOO, Karel: The roadmap to Banking Union: A call for consistency, in *CEPS Commentary* 2012. 4-5.

banking regulation.[60] Basically, strong cooperation transforms national authorities to ECB's *"deconcentrated"* bodies with relation to bank's financial supervision.

In the framework of the SSM, ECB directly supervises prudential rules' strict and bias-free justification and the realization of cross-border markets' effective supervision. ECB can make regulations, accept recommendations and make decisions in connection with these tasks. ECB will have serious investigative competences in order to carry out its supervisory tasks, furthermore, it can impose administrative penalties for the purpose of carrying out tasks transferred to it.[61] With regards to credit institutions being under the effect of SSM, ECB's competences will include credit institutions' authorization, assess notifications of the acquisition, determining prudential measures or carry out supervisory reviews. These competences are currently practiced by national supervisory authorities and their practice is raised to European Union level by the SSM regulation.

A new organizational unit is being formed for the carrying out of tasks in frames of SSM; this is being the so called *Supervisory Board*. The Supervisory Board composed of its Chair and Vice Chair, four representatives of the ECB and one representative of the national competent authority in each participating Member State. All members of the Supervisory Board shall act in the interest of the Union as a whole. It is significant that the Supervisory Board does not have real decision-making competence as it only carry out preparatory works regarding the supervisory tasks conferred on the ECB and propose to the Governing Council of the ECB complete draft decisions, according to the SSM regulation. Simultaneously with this, the SSM regulation sets detailed rules for the separation of the supervisory function from monetary policy, which effectiveness is questioned by the Governing Council's final decision-maker position.[62]

The SRM, the second pillar of the Banking Union can be further divided into two (regulative) pillars. The first pillar is the SRM regulation and the SRM directive, which were accepted by the Council on 14th and on 15th July 2014. These rules determine the functions, procedures (resolution planning, early intervention, resolution objectives, tools, etc.) of uniform resolution, and rules of the institutional framework. The second pillar is the intergovernmental agreement summarizing special rules referring to the formation of *Single Resolution Fund*.[63]

With respect to the SRM Dir., each Member State has to designate one or, exceptionally, more resolution authorities that are empowered to apply the resolution tools and exercise the resolution powers. It can be the central bank, the competent ministry, or other public administrative authority to fulfil this aim. In Hungary, the Hungarian National Bank will carry out resolution authority tasks. Regarding SRM's essence, it will be a multi-actor, complex system, in which the followings will participate: (1) ECB as the SSM's supervisory authority; (2) the Board consisting of participating member states' resolution authority representatives as preparing decisions; (3) the Commission or the Council as the final decision maker and (4) the Single Resolution Fund as the financer of resolution costs. Here I have to emphasize that the legal base of the formation of the Board – as almost of the whole supervisory reform process – is Article 114 of TFEU, which I am going to elaborate on in the following part of the study.

One of SRM's most significant innovations is the introduction of the so called *bail-in tool*. Its essence is that they recapitalise the bank via extruding shareholders or cutting their share (*"haircut"*), also, they either write off creditor demands, decrease them or transform them into stocks. Its objective is that costs of the stabilization of financial institutions facing bankruptcy are not bore by tax-payers but shareholders and creditors as well.

The field of the Union's deposit-guarantee can currently be regarded as a harmonized area. The minimal amount of compensation since 2009 has been 100 000 euros in EU member states. The CDGS cannot be regarded as significant in the current status of the Banking Union; the priority is to set forth the first two pillars. Because of this, CDGS will not be further included in my study.

4. In the name of integration, namely, loosening the legal frames and the reinterpretation of the Meroni-doctrine

[60] MÓRA, Mária: Mit ér a bankúnió fiskális integráció nélkül? in *Hitelintézeti Szemle*, Vol. 12. No. 4. (2013) 328.
[61] For more details about the SSM *see* FERRAN, Eilis – BABIS, Valia: The European Single Supervisory Mechanism, in *University of Cambridge Faculty of Law Research Paper*, No. 10/2013.
[62] About the separation of the supervisory function from the monetary policy, *see* KÁLMÁN, János: Toward the European Federation? Reform Processes in the Financial Stability System of the European Union, especially to the Early Concept of European Bankunion, in *US-China Law Review*, Vol. 10. No. 1. (2013) 46-67.
[63] *See* KREISZ Brigitta: *Bankunió pillérről pillérre 2. rész: Az Egységes Bankszanálási Mechanizmus,* Lendület HPOPs Kutatócsoport, 2014. http://hpops.tk.mta.hu/blog/2014/04/bankunio-pillerrol-pillerre-2-resz (2014.07.21.).

As it can be seen from the above mentioned, after the crisis, the European Union's legislative activity in connection with the regulation and supervision of the financial market was characterized with strong task- and competence centralization endeavours and is still characterized with it in secondary (but not primary) law. That is exactly why the most complicated and most significant question is that among what limitations these endeavours can prevail from legal point of view. What heights can centralization, or nicely expressed, integration can achieve among legal frames? What is that point after which the integration surpasses the framework of current foundation treaties?

Centralization's (integration's) margin, borders are set by the rules of primary law on delegation of competences and by the case law of the European Court of Justice (hereinafter: ECJ). Article 5 of the Treaty on European Union (hereinafter: TEU) says that – as one of the most significant rules of the European Union common law – the limits of Union competences are governed by the *principle of conferral*. According to the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein. Every such competence which Treaties have not conferred to the Union, remain at member states. Hence, the principle expresses that Member States further remain the lords of the Treaties; they continue to be holders of national sovereignty.[64] It comes from the principle of conferral that every secondary legal act must have a legal basis in specific Treaty articles, or primary European law. The ECJ review the legality of legislative acts and if the legislator chose the act's legal basis wrong (*ultra vires*) the Court declare the act concerned to be void, based on Article 263 and 264 TFEU. It is another significant question in connection with the delegation of competences that who do Member States transfer part of their competences to, hence, according to Article 17 TEU, the *Commission ensure* the application of the Treaties, and of measures adopted by the institutions pursuant to them. (…) It shall exercise coordinating, e*xecutive and management functions*, as laid down in the Treaties. That is – as a quasi separation of powers rule – Article 17 TEU appoints the Commission for the implementation of (primary and secondary) Union law, along determined conditions.

Simultaneously with the widening of the European Union's tasks, the level of bodies under the European institutions was formed, from which I have to highlight the diffuse system of the so called *European agencies*. As a reaction to organizational expansion, the *second level* of *delegation of competences* has been formed – among the principle of conferral –, which can also be understood as delegation of competences inside the organizational system of the Union. We can distinguish two cases on this level. On the one hand, we can distinguish competences delegated to the Commission by Union legislators, on the other hand, the delegation of those competences which were originally delegated to the Commission by the Treaties.[65] The first case is handled by Article 290 and 291 TFEU. Primary law does not rule on the conditions of the second case, its rules were formed by case laws of the ECJ (the so called *Meroni-doctrine*).

The limits of centralization (integration) endeavours are partly determined by the principle of conferral – according to which the Union can only practice such competences which were transferred to it by member states through the foundation treaties, via limiting their own sovereignty – and as its outcome, the existence of an adequate legal basis necessary for secondary legislation. On the other hand, centralization's (integration's) limits are the frames of delegation of competences among the European Union bodies written in Articles 290 and 291 TFEU, connecting to which the primary question is whether it can be regarded as a closed delegation system or not. On the third part, the court case law referring to the delegation of Commission competences also limits the deepening of integration among legal frameworks. The extent of the European financial supervisory architecture formed as the effect of the crisis was affected by all three limitations and the court's interpretation – as I am going to elaborate on it – *strongly widened the legal limits of competences' centralization in the name of integration*.

The permissibility of the European financial supervisory system's reformation via Union law became questionable by the United Kingdom of Great Britain and Northern Ireland in front of the ECJ, in its action aiming at the annulation of ESMA competence connecting to short selling. Despite that in the action of Great Britain questioned the legal limits of centralization endeavours in connection with only one competence rule – and not in connection with the whole new supervisory system –, the ECJ's decision is a *milestone* regarding the above mentioned limits.

4.1. The ESMA case's background in short

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[64] VÁRNAY, Ernő – PAPP, Mónika: *Az Európai Unió joga*, 2010, Complex, Budapest, 183.

[65] LAFARGE, Francois: The legal basis and the legal constraints of EU agencies (and the transformation of the executive function in the EU), in ONGARNO, E. (ed.): *EU Agencies*, Palgrave MacMillan, 2013. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2249873 (2014.07.21.).

Investigating short selling's legal background, we can realize that prior to the economic crisis there was no Union legislation and Member State legislations showed considerably various pictures.[66] In September 2008, in the height of the financial crisis – in a so called reaction panic –, more Union Member States and the USA's competent authorities accepted measures for restricting or banning short selling.[67]

The current fragmented approach to short selling and credit default swaps limits the effectiveness of supervision and the measures imposed and results in regulatory arbitrage. It may also create confusion in markets and costs and difficulties for market participants.[68]

Recognizing the further systemic risks hidden in the different regulations, Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (hereinafter: Short selling Reg.) was born on the recommendation of the Commission. The Short selling Reg. tries to ensure the proper functioning of the internal market and to improve the conditions of its functioning, in particular with regard to the financial markets, and to ensure a high level of consumer and investor protection, it is therefore appropriate to lay down a common regulatory framework with regard to the requirements and powers relating to short selling and credit default swaps and to ensure greater coordination and consistency between Member States where measures have to be taken in exceptional circumstances.[69]

According to Article 28 of Short selling Reg., in case of exceptional circumstances, ESMA can order increased *information obligation* for natural or legal persons having net short positions in relation to specific financial instrument or class of financial instruments, and in case of exceptional circumstances, it can *prohibit or impose conditions on,* the entry by natural or legal persons into a short sale or a transaction.

The ESMA can exclusively make these measures if a.) the measures address a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union and there are *cross-border implications*; and b.) no competent authority has taken measures to address the threat or one or more of the competent authorities have taken measures that *do not adequately address the threat*. The competence set in Article 28 of Short selling Reg. is hierarchically superior to Member State authorities' decisions as *measures accepted* by ESMA according to this article are *prevail over any previous measure taken by a competent authorities.*

The United Kingdom (in this part furthermore referred to as Applicant) handed in an action to the ECJ on 1st June 2012, in which it requested the annulation of Article 28 of Short selling Reg. based on Article 263 TFEU. In the action, the Applicant named four pleas in law, which – according to it – give basis to annulations of ESMA's intervention powers in exceptional circumstances.

In the action the Applicant referred to that *firstly*, Article 28 of Short selling Reg. is contrary to the second principle established by the Court of Justice in the Meroni case,[70] because when ESMA is required to take action under Article 28 entail a large measure of discretion. *Secondly*, Article 28 purports to empower ESMA to impose measures of general application which have the force of law, contrary to the Court's decision in Case Romano.[71] *Thirdly*, Article 28 purports to confer on ESMA a power to adopt non-legislative acts of general application, whereas in the light of Articles 290 and 291 TFEU, the Council has no authority under the Treaties to delegate such a power to a mere agency outside of these provisions.. Finally, *fourthly*, if and to the extent that Article 28 were interpreted as empowering ESMA to take individual measures directed at natural or legal persons, it would be ultra vires Article 114 TFEU.

As *Balázs Fekete* also highlights, "the following conviction in the focus point of the Applicants was that Article 28 provides such a wide discretional competence to ESMA, which delegation is against the law because of certain foundation treaty rules and because of the existing ECJ case law."[72] Besides the validity of the concrete competence, the ECJ has to form an opinion in all above mentioned theoretically significant

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[66] *See* PAYNE, Jennifer: The Regulation of Short Selling and Its Reforms in Europe, in *European Business Organization Law Review*. Vol. 13. Issue 3. (2012) 429.

[67] BEBER, A. – PAGANO, M.: Short-Selling Bans Around the World: Evidence from the 2007–09 Crisis, in *The Journal of Finance*, Vol. 68. Issue 1. (2013), 343.

[68] *See* Propusal fo a regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Defailt Swaps – COM (2010) 482. 2.

[69] *See* Short selling Reg. preamble point 2.

[70] European Court of Justice (1958): *„Meroni v. High Authority"* (Case 9/56).

[71] European Court of Justice (1981): *„Giuseppe Romano v. Institut national d'assurance maladie-invalidité."* (C-98/80).

[72] Fekete, Balázs: Az Európai Értékpapír-piaci Hatóság rendkívüli válsághelyzetben alkalmazható beavatkozási hatásköre nem ellentétes az uniós jogrend követelményeivel, Lendület HPOPs Kutatócsoport, 2014. http://hpops.tk.mta.hu/blog/2014/02/europai-ertekpapir-piaci-hatosag (2014.07.21.).

interpretation of law that mark the limits of centralization, the ESMA case's *systemic importance* originates from this.[73] These theoretically significant questions are going to be investigated via following the study's logical order, not according to the order of the Judgement.[74]

4.2. In the name of integration I. – The question of legal basis

Hence, the first theoretically significant question referred to the interpretation of the notion of the measures for approximation and Article 114 TFEU determined as the legal basis of the competence included in Article 28 of Short selling Reg. Based on Article 114 TFEU – which Article is also the legal basis of the formation of the ESFS and the SRM –, *save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.*

According to the Applicant, Article 28 of Short selling Reg. is not intended to authorise ESMA to take individual measures directed at natural or legal persons. On the contrary, measures that may be adopted under that provision are of general application. Furthermore, he Applicant considers that, if, however, Article 28 of Short selling Reg. is to be regarded as authorising ESMA to direct decisions at natural or legal persons, that provision is *ultra vires* Article 114 TFEU. That provision does not empower the EU legislature to take individual decisions that are not of general application or to delegate to the Commission or a Union agency the power to adopt such decisions. Hence, the theoretically significant question can be asked in a way that whether those decisions addressed to financial institutions which have prevail over any previous measure taken by a competent authorities can be regarded as measures for approximation according to Article 114 TFEU or not. The theoretical significance of the question is showed by that the advocate general (*Niilo Jääskinen*) acting in the case and the court has different theoretical standpoints.

In the Advocate General's opinion,[75] referring to judgement made in the ENISA case,[76] he ascertained upon the court case law that the EU legislature may deem it necessary to provide for the establishment of a Community body responsible for contributing to the implementation of a process of harmonisation 'in situations where, in order to facilitate the uniform implementation and application of acts based on that provision, the adoption of non-binding supporting and framework measures seems appropriate'. Furthermore, it is important that in the ENISA case the ECJ ruled that nothing in the wording of Article 114 TFEU implies that the addressees of the measures adopted by the EU legislature on the basis of that provision can only be Member States. Hence, Article 114 TFEU provides legal basis for that addressees of acts accepted upon this can even be natural or legal persons. The Advocate General determined *that the decision making powers of ESMA under Article 28 of Short selling Reg. bear little resemblance to the measures described by the Court in these important passages of the ENISA ruling.* First of all, *measures* based on Article 28 of Short selling Reg. are *legally binding*, while the Court investigated non-legally binding measures in the ENISA case. While this is not objectionable in and of itself, it is difficult to envisage how the exercise of a power under Article 28 of Short selling Reg. could contribute to harmonisation of the kind described by the Court in *ENISA*. Rather *its function is to lift implementation powers* contained in Article 18, 20 and 22 of Short selling Reg. *from the national level to the EU level* when there is disagreement between ESMA and the competent national authority or between national authorities.[77] Hence, the Advocate layed down that *the outcome of the activation* of ESMA's powers under Article 28 of Short selling Reg. *is not harmonisation, or the adoption of uniform practice at the level of the Member States*, but the replacement of national decision making with EU level decision making.[78]

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[73] MARJOSOLA, Heikki: Case C-270/12 (UK v Parliament and Council) – Stress Testing Constitutional resilience of the Powers of EU Financial Supervisory Authorities – A Critical Assessment of the Advocate General's Oppinion, in *EUI Working Paper Law* 2014/02, 4.

[74] *C-270/12. United Kingdom of Great Britain and Northern Ireland v. European Parliament and Council of the European Union – Judgement (European Court of Justice), 22 January 2014* (hereinafter: Judgement).

[75] *C-270/12. United Kingdom of Great Britain and Northern Ireland v. European Parliament and Council of the European Union – Opinion of Advocate General, 12 September 2013.* (hereinafter: Opinion).

[76] *C-217/04. United Kingdom v. European Parliament and Council, 2 May 2006.*

[77] Opinion point 50.

[78] The Advocate General marked that the Article 352 TFEU could be an adequate legal basis for the competences delegated to the ESMA with the Article 28 of Short selling Reg. With this legal basis the problem is that the Council,

The ECJ, deviating from the Advocate General's opinion investigated whether the two conditions in Article 114 TFEU prevail with relation to Article 28 of Short selling Reg. So the ECJ analysed that, on the one hand, whether the measures according to Article 28 of Short selling Reg. *comprise measures for the approximation of the provisions laid down by law, regulation or administrative action in the Member States* and, on the other hand, *have as its object the establishment and functioning of the internal market*.

The ECJ first determined that by the expression 'measures for the approximation', the authors of the TFEU intended to confer on the Union legislature, depending on the general context and the specific circumstances of the matter to be harmonised, discretion as regards the most appropriate method of harmonisation for achieving the desired result, especially in fields with complex technical features.[79] Regarding this, the ECJ has held in that regard that such discretion may be used *in particular to choose the most appropriate method of harmonisation* where the proposed approximation requires highly technical and specialist analyses to be made and developments in a specific field to be taken into account.[80] Continuing the Court's argumentation, accordingly, the EU legislature, in its choice of method of harmonisation and, taking account of the discretion it enjoys with regard to the measures provided for under Article 114 TFEU, *may delegate to a Union body, office or agency powers for the implementation of the harmonisation sought. That is the case in particular where the measures to be adopted are dependent on specific professional and technical expertise and the ability of such a body to respond swiftly and appropriately*.[81]

The ECJ makes clear that the aim of the orderly functioning and integrity of the financial markets or the stability of the financial system in the EU includes the establishment of an appropriate mechanism which would *enable measures to be adopted throughout the EU which may take the form*, where necessary, o*f decisions directed at certain participantsin those markets*.[82] The EU legislature therefore considered it appropriate to lay down a common regulatory framework with regard to the requirements and powers relating to short selling and credit default swaps and to ensure greater coordination and consistency between Member States where measures have to be taken in exceptional circumstances. Therefore, the harmonisation of the rules governing such transactions is intended to prevent the creation of obstacles to the proper functioning of the internal market and the continuing application of divergent measures by Member States.[83] Taking all these into account, in the ECJ interpretation, competence set in Article 28 of Short selling Reg. corresponds to criterion written in Article 114 TFEU.

The significance of the decision in connection with the centralization's borders can be traced in that according to the ECJ's interpretation Union bodies' practice of their competences is based on such general, Union interests which in nature and in quality differ from the individual Member State interests and cannot be realized exclusively with the cooperation of Member State authorities.[84] Therefore, competences ensuring direct Union intervention (supervision) are compatible with Article 114 TFEU in connection with the significantly integrated European financial markets, and – in opposition with the Advocate General's opinion which tried to set up limits for the application of the notion of "measures for approximation" –, unanimous decision making set in Article 352 TFEU is not necessary for them. Such interpretation of Article 114 TFEU gives way (not only) to the further integration of financial market's European supervisory system. Besides, such wide interpretation creates the risk that the scope of "measures for approximation" could be expanded almost indefinitely, depriving of Article 114 TFEU inherent limits and thus the principle of legality can be violated.[85]

4.3. In the name of integration II. – The interpretation of Articles 290 and 291 TFEU

According to the argumentation of the United Kingdom, because of that Articles 290 TFEU and 291

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acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament to adopt the appropriate measures.

[79] Judgement point 102.

[80] Judgement point 103.

[81] Judgement point 105.

[82] RAPASSI, René: Assessment of the Judgement of the European Court of Justice in Case 270/12, United Kingdom v Council and European Parliament. Impact of this judgement on the proposal of the SRM regulation. http://www.sven-giegold.de/wp-content/uploads/2014/01/Assessment-ECJ-Case-C-270-12-and-relevan ce-for-the-SRM1.pdf (2014.07.21.).

[83] Judgement point 114.

[84] FEKETE: op. cit.

[85] BABIS, Valia: The Power to Ban Short-Selling: The Beginning of a New Era for EU Agencies? in *Legal Studies Research Paper Series*, No. 27/2014. 2.

TFEU circumscribe the circumstances in which certain powers may be given to the Commission, the Council has no authority under the Treaties to delegate powers such as those provided for in Article 28 of Short selling Reg. to an EU agency. Therefore, the ECJ had to take a side in that whether legal framework entering into the place of so called comitology with the Treaty of Lisbon mean a closed system or not. Whether creators of TFEU wished to create such an only legal framework in Articles 290 and 291 TFEU which only makes the delegation of certain competences exclusively – in special cases for the Council – for the Commission possible, or the Union legislator have other systems of delegation such competences to Union organizations or authorities.

"The practice of delegated competences and the taking of adequate executive measures are indispensable tools of the enforcement of Union law, which suppos the unified interpretation of the TFEU's new regulations".[86] Based on Article 290 TFEU a legislative act may delegate to *the Commission* the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. Article 291 para. 1 TFEU lies down that Member States shall adopt all measures of national law necessary to implement legally binding Union acts. Para. 2 says that where uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission, or, in duly justified specific cases and in the cases provided for in Articles 24 and 26 of the Treaty on European Union, on the Council. By Article 290 the Commission can only be authorized to accept acts with general application, while according to Article 291 the Commission (in certain cases the Council) can also apply individual measures and acts with general application for the sake of unified implementation of the legally binding Union acts.[87] The main constitutional concern relating to Article 290 TFEU delegated acts appertains to democratic accountability. In contrast, the main constitutional focus in relation to Article 291 TFEU implementing acts relates to respect for the primary competence of the Member States with respect to implementation of EU law, and the institutional balance between the Council and the Commission when they assume implementing roles.[88]

Continuing the train of thoughts, it is important to highlight that regarding Article 291 a European authority cannot be the addressee of an executive competence *expressis verbis*. The opinion of the Advocate General also took it into consideration, as is says that Article 291 TFEU, like Article 290 TFEU, does not refer to agencies as subjects on whom implementing powers can be conferred at the EU level. However, given that implementing powers do not extend to amending or supplementing legislative acts with new elements, fundamental constitutional principles do not in my opinion prevent the legislator from conferring such powers on agencies as a midway solution between vesting implementing authority in either the Commission or the Council, on the one hand, or leaving it to the Member States, on the other.[89] This argumentation was taken over by the ECJ as well. In the Judgement the ECJ noted in that regard that, while the treaties do not contain any provision – hence, neither do Articles 290 and 291 TFEU – to the effect that powers may be conferred on a Union body, office or agency, a number of provisions in the TFEU none the less presuppose that such a possibility exists.[90] Under Article 263 TFEU, the Union bodies whose acts may be subject to judicial review by the Court include the 'bodies, offices' and 'agencies' of the Union. The rules governing actions for failure to act are applicable to those bodies pursuant to Article 265 TFEU. Article 267 TFEU provides that the courts and tribunals of the Member States may refer questions concerning the validity and interpretation of the acts of such bodies to the Court. Such acts may also be the subject of a plea of illegality pursuant to Article 277 TFEU.[91]

The ECJ noted that Article 28 Short selling Reg. vests ESMA with certain decision-making powers in an area which requires the deployment of specific technical and professional expertise. However, that conferral of powers does not correspond to any of the situations defined in Articles 290 TFEU and 291 TFEU, but cannot be considered in isolation. On the contrary, that provision must be perceived as forming part of a series of rules designed to endow the competent national authorities and ESMA with powers of intervention to cope with adverse developments which threaten financial stability within the Union and market confidence. The ECJ deducted that from this rough argumentation that Article 28 of Short selling Reg. read in conjunction with the other regulatory instruments adopted in that field identified above, cannot be regarded as undermining the rules governing the delegation of powers laid down in Articles 290 TFEU and

[86] OSZTOVITS, András (ed.): *Az Európai Unióról és az Európai Unió Működéséről szóló Szerződések magyarázata 3.* 2011, Complex, Budapest, 3099.
[87] OSZTOVITS: op. cit. 3105-3106.
[88] Opinion point 83.
[89] Opinion point 86.
[90] Judgement point 79.
[91] Judgement point 80.

291 TFEU.[92]

Defects of the ECJ's argumentation probably come from that in spite that it agreed with the Advocate General's argumentation, it did not wish to make it as part of the Judgement. According to the Advocate General's argumentation, Article 28 of Short selling Reg. does not violate Articles 290 and 291 TFEU because it delegated the intervention competence to ESMA directly with the legislative act of the Union's legislator – *choosing the solution outside Articles 290 and 291 TFEU*. The EU legislature is not acting as a 'delegating authority' when it confers implementing powers on institutions, agents, or other bodies of the Union, but *a constitutional actor exercising its own legislative competence*, as conferred on it by the higher constitutional charter, i.e. the Lisbon Treaty.[93]

According to Articles 290 and 291 TFEU the addressee of transfer may only be the Commission – in some cases based on Article 291 the Council –, however, we can deduct it from the argumentation of the judgement that according to the ECJ's interpretation, the legal framework formed in Articles 290 and 291 TFEU cannot be regarded as the only system with which competences can be delegate to any European body. With this argumentation, the ECJ stated not less than *that European agencies actually mean the alternative of the implementation of Union law besides Member States and implementation by the European institutions*, even if *expressis verbis does not come from the text of founding treaties*. Among the framework of the Meroni-doctrine, which I am going to elaborate on in the next point, in areas requiring special competencies, the Union legislator can delegate regulative and executive competencies to European agencies having special competency. Based on these, the ECJ distinguish the delegation of powers to EU agencies that is only indirectly recognised in the Treaties, from the explicit delegation of powers to the European Commission under Article 290 and 291 TFEU.[94]

4.4. In the name of integration III. – The Meroni-doctrine's reinterpretation

The essence of the Meroni judgement[95] is that the Court differentiated between clearly defined executive powers and discretionary powers having wide margin of discretion. The previous ones can be conferred, while the latter ones were qualified as non-conferrable.

In the Meroni-case the Court set those criteria with which fulfilment delegation of competences is allowed. Based on these, the delegator can only delegate competences to administrative agencies if: *(1)* a delegating authority cannot confer upon the authority receiving the delegation powers different from those which it has itself received under the treaty (general principle); *(2)* such a delegation of powers can only involve clearly defined executive powers, the use of which must be entirely subject to the supervision of the delegator; *(3)* a delegation of powers cannot be presumed, even when empowered to delegate its powers the delegating authority must take an express decision transferring them; *(4)* the transfer must not disturb the institutional balance between European institutions.

The judgment of the Meroni-case was further supplemented by several later judgements, which together form the so called Meroni-doctrine.[96] The framework of the delegation of competences became complete with the Romano case, as the ECJ, within the framework of the EEC Treaty in connection with a Union organization set the general prohibition of legislative competences' further delegation, the prohibition of the delegation of powers having wide margin of discretion, and it determined the necessary system of criterion regarding every other cases of delegation of powers.

The strict system of conditions set up in the Meroni-case and the prohibition of the delegation of powers having wide margin of discretion has stood for fifty years as constitutional limits to delegation,[97] which prohibition continuously became flexible in the court' case law[98] since the formation of the new type of European authorities. The ESMA case allowed the ECJ to summarize and reinterpret the Meroni-doctrine's

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[92] Judgement point 80.
[93] Opinion point 91.
[94] PELKMANS, Jacques – SIMONCINI, Marta: Mellowing Meroni: How ESMA can help build the single market, in *CEPS Commentary*, 3. http://www.ceps.eu/book/mellowing-meroni-how-esma-can-help-build-single-market (2014.07.21.).
[95] *See* KOEN, Lenaerts: Regulating the regulatory process: Delegation of powers in the European Community, in *European Law Review*, Vol. 18. No. 1. (1993) 30.
[96] *See* for more details KÁLMÁN János: A tilalomtól a rugalmas értelmezésig, avagy a hatáskör-átruházás az Európai Unió Bíróságának joggyakorlatában, in *Studia Juridica et Politica Jaurinensis,* Vol. 2. No. 1. (2014) (forthcoming).
[97] CRAIG, Paul: *EU Administrative Law*. 2012, Oxford University Press, Oxford, 155.
[98] About the process *see* for more details KÁLMÁN (2014): op. cit.

strict rules in the context of the introduced Treaty of Lisbon.[99]

As the first step, the ECJ noticed that the bodies in question in *Meroni* case were entities governed by private law, whereas ESMA is a European Union entity, created by the EU legislature.[100] As the second step the court stated that unlike the case of the powers delegated to the bodies concerned in *Meroni* case, the exercise of the powers under Article 28 of Short selling Reg. is circumscribed by various conditions and criteria which limit ESMA's discretion.[101] Finaly the ESJ noted that contrary to the applicant's claims, those powers do not, therefore, imply that ESMA is vested with a 'very large measure of discretion' that is incompatible with the TFEU for the purpose of that judgment.[102]

The new Meroni-doctrine referring to the delegation of competences can be built up from the judgement's reasoning – with regards to what has been included in the Advocate General's opinion. Based on this, *competences having wide margin of discretion can be delegated to other Union organization than the Commission if (1) this organization is a European Union entity, created by the EU legislature (point 43), (2) the exercise of the powers are circumscribed by various conditions and criteria which limit the discretion (point 45), and (3) the exercise of the delegated powers are precisely delineated and amenable to judicial review in the light of the objectives established by the delegating authority (point 53.).* It is important to highlight that competences delegated via this way include individual decisions and measures with general application, too.

Hence, it can be seen that the ECJ strongly reinterpreted the framework of delegation of competences, taking the wide formation of the ECJ review into account, which – together with literature opinions[103] – makes the maintenance of strict conditions laid down by the Meroni-doctrine useless. At the same time, the Court discarded the difference between clearly defined executive powers and discretionary powers having wide margin of discretion, with that it resolved the prohibition of the delegation of powers having wide margin of discretion. Several representative of the literature welcomed the reinterpretation of the Meroni-doctrine, as the new framework suits the Union's current improvement more.[104]

5. Conclusions

The ESFS was formed as the first step of the European Union's reform process, "compelled" by the economic crisis. However, the banking system's bailout packages raised government debt to such levels which led to sovereign credit crisis and the deflection of the Euro. Hence, reform processes continued to move towards the more and deeper integration, putting the question: what kind of Europe do we want? Do we want the United States of Europe with federal organization or the Europe of Nations with strengthened Member State position, without political integration? We can list several reasons pro and contra all future plans, however, with the analysis of institutional changes it becomes clear that the formation of the Banking Union is not followed by the weakening of Union competencies but by its drastic strengthening. The introduction of the Banking Union, and primarily the SRM, its second pillar cannot reach its aim without adequate financial background, hence, the further deepening of integration is needed with the approach of fiscal policy, which is direct consequence and wish is the remedy of the lack of democratic legitimacy, which shows into the direction of political union. We can quarrel on the European Union's future, but decision makers have already voted for one way with the introduction of reform processes. In the deepening of integration the ECJ does a good job, and as it elaborated on it in its study, they widened the founding treaties' regulations to the widest in order to maintain the reform processes. We cannot solve every question with the integration-friendly interpretation but the principle of legality has to be blocked against the unlimited widening of founding treaties' regulations mainly Article 114 of TFEU which is the seed of reforms. The European Union is further based on the principle of conferral, as it cannot be regarded as a

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[99] Under Article 263 TFEU, the Union bodies whose acts may be subject to judicial review by the Court include the 'bodies, offices' and 'agencies' of the Union. The rules governing actions for failure to act are applicable to those bodies pursuant to Article 265 TFEU. Article 267 TFEU provides that the courts and tribunals of the Member States may refer questions concerning the validity and interpretation of the acts of such bodies to the Court. Such acts may also be the subject of a plea of illegality pursuant to Article 277 TFEU. *So the judicial controll over the european agencies become full, which was completely lacking at the time of the Meroni judgement.*

[100] Judgement point 43.

[101] Judgement point 45.

[102] Judgement point 54.

[103] VOS, Ellen: Reforming the European Commission: What role to play for EU agencies? in *Common Market Law Review*, Vol. 37. No. 5. (2000) 1123-1124.

[104] *See* BABIS: op. cit. 2.; PELKMANS – SIMONCINI: op. cit. 6.

sovereign state, hence, for the sake of ensuring the new institutional reforms' stability – before further reforms – their treaty base must be laid down.

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