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# From Global Financial Crisis to Sovereign Debt Crisis and Beyond: What Lies Ahead for the European Monetary Union?

Caroline Bradley

*University of Miami School of Law*, [cbradley@law.miami.edu](mailto:cbradley@law.miami.edu)

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# From Global Financial Crisis to Sovereign Debt Crisis and Beyond: What Lies Ahead for the European Monetary Union?

Caroline Bradley\*

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## I. INTRODUCTION

Before stepping down as President of the European Central Bank (“ECB”) in October 2011, Jean-Claude Trichet stated that “the dialectic between the individual nation states and the community of nations” was “at the core of the European project” and that it presented “some of Europe’s most fundamental challenges.”<sup>1</sup> As the European Union (“EU”) navigated through the global financial crisis and the European sovereign debt crisis,<sup>2</sup> a number of fundamental challenges became very visible. During the financial crisis, the EU institutions addressed issues of reforming financial regulation at the EU level,<sup>3</sup> while governments of the EU’s Member States faced political

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\* Professor of Law, University of Miami School of Law, PO Box 248087, Coral Gables, FL, 33124, cbradley@law.miami.edu; <http://blenderlaw.umlaw.net/>. I would like to thank Michael Froomkin, Lucas Jensen, and Markus Wagner for assistance and comments on earlier versions of this Article.

<sup>1</sup> Jean-Claude Trichet, President of the Eur. Cent. Bank [ECB], Speech at Humboldt Univ., Berlin: Tomorrow and the Day After Tomorrow – A Vision for Europe (Oct. 24, 2011), available at <http://www.bis.org/review/r111025e.pdf>.

<sup>2</sup> See, e.g., Nicholas Dorn, *Regulatory Sloth and Activism in the Effervescence of Financial Crisis*, 33 L. & POL’Y 428, 428 (2011) (“In 2010 it became clear that sovereign states, which had bailed out the banking sector, were themselves becoming targets of a mixture of financial speculation and genuine fears and uncertainties over their financial health.”).

<sup>3</sup> See, e.g., *Commission Proposal for European Financial Supervision*, at 3, COM (2009) 252 final (May 27, 2009) (proposing the establishment of a European Systemic Risk Council and “a European System of Financial Supervisors (ESFS) consisting of a robust network of national financial supervisors working in tandem with new European Supervisory Authorities to safeguard financial soundness at the level of individual financial firms and protect consumers of financial services”); *Proposal for a Directive Amending Directive 94/19/EC on Deposit Guarantee Schemes as Regards the Coverage Level and the Payout Delay*, COM (2008) 661 final (Oct. 15, 2008).

pressures to respond to failures of financial firms as domestic events.<sup>4</sup> Many of those same governments participated in the Group of Twenty Finance Ministers and Central Bank Governors (“G20”) meetings and committed to taking collective transnational action in response to the crisis.<sup>5</sup> The sovereign debt crisis called for collective action at the same time as it illuminated the divergent interests of different euro area states and the distinction between the members of the eurozone and the broader EU membership.<sup>6</sup> While many commentators speculated about whether Greece would exit the euro,<sup>7</sup> and whether the euro<sup>8</sup> or even the EU would collapse,<sup>9</sup> the EU institutions

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<sup>4</sup> See, e.g., FIN. SERVS. AUTH., THE TURNER REVIEW: A REGULATORY RESPONSE TO THE GLOBAL BANKING CRISIS 36 (2009) (U.K.), available at [http://www.fsa.gov.uk/pubs/other/turner\\_review.pdf](http://www.fsa.gov.uk/pubs/other/turner_review.pdf) (“The crisis revealed fault lines in the global regulation and supervision of some of these cross-border firms, which raise fundamental issues about the appropriate future approach. The essence of the problem—as the Governor of the Bank of England, Mervyn King has put it—is that global banking institutions are global in life, but national in death.”); cf. EU-US COAL. ON FIN. REGULATION, INTER-JURISDICTIONAL REGULATORY RECOGNITION: FACILITATING RECOVERY AND STREAMLINING REGULATION 8 (June 2012) (“[T]he absence of any effective global framework for addressing a global financial crisis meant that the immediate legislative and regulatory responses to the crisis were resolutely national or, at best, regional.”).

<sup>5</sup> The G20 is comprised of Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, the Republic of Korea, Turkey, the United Kingdom, the United States, and the EU. France, Germany, Italy, and the United Kingdom are all members of the EU. For an example of the G20’s reaction to the financial crisis see, e.g., Grp. of Twenty [G20], Declaration on Strengthening the Financial System (Apr. 2, 2009) [hereinafter G20 Declaration], available at <http://www.g20.utoronto.ca/2009/2009ifi.html>; cf. Eric J. Pan, *Challenge of International Cooperation and Institutional Design in Financial Supervision: Beyond Transgovernmental Networks*, 11 CHI. J. INT’L L. 243, 245 (2010) (“For financial law scholars, the G20, both in its existence and in the types of actions it puts forward, represents only a temporary solution to an on-going problem of regulation of international financial markets and institutions.”).

<sup>6</sup> See, e.g., FOREIGN AND COMMONWEALTH OFFICE, FUTURE OF EUROPE DEPARTMENT, REVIEW OF THE BALANCE OF COMPETENCES BETWEEN THE UNITED KINGDOM AND THE EUROPEAN UNION, 2012, Cm. 8415, at 5 (U.K.) [hereinafter BALANCE OF COMPETENCES], available at <http://www.fco.gov.uk/resources/en/pdf/publications/eu-balance-of-competences-review.pdf> (“The crisis in the Eurozone has intensified the debate in every country on the future of Europe and there is no exception here. Now is the right time to take a critical and constructive look at exactly which competences lie with the EU, which lie with the UK, and whether it works in our national interest.”).

<sup>7</sup> See, e.g., Cinzia Alcidi et al., ‘Grexit’: Who Would Pay for It? (Ctr. Eur. Policy Studies, Policy Brief No. 272, 2012), available at <http://www.ceps.be/book/grexit-who-would-pay-it>.

<sup>8</sup> For a view that the European sovereign debt crisis should not be seen as a threat to the euro, see Pascal Salin, *There Is No “Euro Crisis,”* WALL ST. J., July 18, 2012, <http://online.wsj.com/article/SB10001424052702303754904577530381082945926.html>.

<sup>9</sup> See, e.g., Martin Schulz, President of the Eur. Parliament, Speech to the Members of the Eur. Comm’n (Apr. 25, 2012) [hereinafter Schulz Speech of April 25, 2012], transcript available at [http://www.europarl.europa.eu/the-president/en/press/press\\_release\\_speeches/speeches/sp-2012/sp-2012-april/speeches-2012-april-2.html](http://www.europarl.europa.eu/the-president/en/press/press_release_speeches/speeches/sp-2012/sp-2012-april/speeches-2012-april-2.html) (“For the first time in the history of the European Union, collapse of the EU has become a realistic scenario.”).

worked to hold the eurozone and the EU together.<sup>10</sup> But tensions remain;<sup>11</sup> for example, the Government of the United Kingdom insists that the problems in the eurozone are matters for the eurozone to solve, rather than for the broader EU.<sup>12</sup> As the EU moves toward further integration to stabilize the eurozone, it is not clear how the arrangements for financial supervision within the eurozone and the EU will develop.<sup>13</sup> While the crises in the EU raise issues about the relationships between the Member States and about the extent to which policy making is and should be centralized within the EU, they also raise issues about the extent to which policy making, with respect to finance and financial regulation, is a technocratic or democratic matter.

This Article describes the evolution of the financial and sovereign debt crises and how the EU has responded to the crises. In examining the crises and the EU's reactions, the Article argues that the crises clearly demonstrate a tension in the EU between democratic accountability and bureaucratic decision making. This is a tension that recurs in the EU in many policy fields,

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<sup>10</sup> See, e.g., *Commission Proposal for Commission Work Programme 2012: Delivering European Renewal*, at 2, COM (2011) 777 final (Nov. 15, 2011) ("The European Union is confronted with the challenge of a generation. An economic challenge, that affects families, businesses and communities across Europe. But also a political challenge, to show that the European Union is equal to the task. The European Union can and should make a real difference to how Europeans face up to today's crisis.").

<sup>11</sup> Cf. Nicole Scicluna, *When Failure Isn't Failure: European Union Constitutionalism After the Lisbon Treaty*, 50 J. COMMON. MKT. STUD. 441, 452 (2012) ("[T]he very projects that were meant to unite European citizens and promote their common identity, such as the euro, are now straining transnational solidarity and producing a rise in nationalist and protectionist sentiments.").

<sup>12</sup> See, e.g., BALANCE OF COMPETENCES, *supra* note 6, at 10 ("Looking ahead, the Government will: . . . continue to encourage and support the steps needed to ensure stability and strengthened governance in the Eurozone; . . . ensure that action to tackle the crisis in the Eurozone protects the unity and integrity of the single market; . . . work for more effective regulation of the financial sector which ensures financial stability and protects UK interests.").

<sup>13</sup> See, e.g., *Towards a Genuine Economic and Monetary Union: Report by President of the Eur. Council Herman Van Rompuy No. 120/12 of 26 June, 2012*, at 3 [hereinafter *Towards a Genuine Economic and Monetary Union*], available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131201.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131201.pdf) ("The vision for the future of EMU governance laid out in this report focuses on the euro area Member States as they are qualitatively distinct by virtue of sharing a currency. Nevertheless, the process towards deeper economic and monetary union should be characterised by openness and transparency and be in full compatibility with the single market in all aspects."). Rather than endorsing the document as it stands, the European Council invited

the President of the European Council . . . to develop, in close collaboration with the President of the Commission, the President of the Eurogroup and the President of the ECB, a specific and time-bound road map for the achievement of a genuine Economic and Monetary Union, which will include concrete proposals on preserving the unity and integrity of the Single Market in financial services and which will take account of the Euro Area statement and, inter alia, of the intention of the Commission to bring forward proposals under Article 127.

Council Conclusions 76/12 of 28–29 June, 2012, at 3, available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/131388.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131388.pdf).

not just in the context of financial regulation; but the financial and sovereign debt crises have made the tension especially visible. The EU's system of harmonizing and centralizing financial regulation has developed incrementally over a long period of time, and the incompleteness of the EU's harmonization of financial regulation arguably contributed to the severity of the crises.<sup>14</sup> The sovereign debt crisis has led EU policymakers to try to act quickly to complete harmonization of EU financial regulation and address weaknesses in institutional arrangements for the eurozone, thereby increasing confidence in European financial institutions and sovereign debtors. However, the EU's institutional constraints slow down change; some of the new rules and arrangements require treaty amendments, which are slow to implement. Others will require lengthy negotiations and/or the resolution of legal disputes.<sup>15</sup>

The European sovereign debt crisis demonstrates the mutual dependence of states and financial institutions. European states relied on banks as investors in their debt, and when banks faced difficulties, they looked to states to bail them out.<sup>16</sup> The EU's implementation of international harmonized standards of capital adequacy for banks played a role in the development of this mutual dependence because EU rules allowed banks to continue investing in sovereign debt without calculating the real risks associated with their investment.<sup>17</sup> The original Basel Accord on capital adequacy encouraged banks to hold sovereign debt, and Basel II's changes to capital adequacy requirements, intended to fine-tune risk weightings, relied on sovereign ratings, which underestimated the risks of sovereign default of European states.<sup>18</sup> Under the Basel II standardized approach, banks' holdings of AAA- and AA-rated sovereign debt could be zero risk weighted for capital adequacy purposes.<sup>19</sup> Thus, banks were not required to hold any

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<sup>14</sup> See, e.g., Niamh Moloney, *EU Financial Market Regulation After the Global Financial Crisis: "More Europe" or More Risks?*, 47 COMMON MKT. L. REV. 1317, 1319 (2010) ("At the core of the EU crisis was a destructive imbalance in the regulatory and supervisory architecture.").

<sup>15</sup> Some commentators have challenged the legal foundations of the EU's new financial regulatory agencies. See, e.g., Elaine Fahey, *Does the Emperor Have Financial Crisis Clothes? Reflections on the Legal Basis of the European Banking Authority*, 74 MOD. L. REV. 581, 582 (2011) ("[T]he use of Article 114 TFEU as the legal basis for the EBA raises many difficulties.").

<sup>16</sup> Cf. Press Release, Eurogroup Statement on the Follow-up of the 29 June Euro Summit (July 9, 2012), available at [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/131648.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/131648.pdf) (referring to "the vicious circle" between banks and sovereign states).

<sup>17</sup> See, e.g., Hervé Hannoun, Deputy Gen. Manager, Bank for Int'l Settlements, Speech at the Financial Stability Institute High-Level Meeting: Sovereign Risk in Bank Regulation and Supervision: Where Do We Stand? (Oct. 26, 2011), transcript available at <http://www.bis.org/speeches/sp111026.pdf> ("[I]t is fair to say that we do not know precisely how other jurisdictions treat sovereign risk. The EU directives have the merit of being transparent and it may well be that elsewhere in the world a zero risk weight is also widely applied to sovereign exposures in a more opaque, purely domestic, regulatory process.").

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* at 11 ("[T]he Basel II standardised approach allows a zero risk weight to be applied to AAA and AA- rated sovereigns.").

regulatory capital with respect to such investments. The EU will, in the future, reflect sovereign risk in its capital adequacy rules;<sup>20</sup> but the past failure to do so illustrates a defect in technocratic policy making,<sup>21</sup> one which was costly for European citizens.

The European tensions revealed and exacerbated by the crises are inherent in the EU system. The entity which is now the EU has developed incrementally over time and involves a continuous process of negotiation and renegotiation. The European sovereign debt crisis has encouraged the European Commission to push for more harmonization of financial regulation, for example, by proposing the use of legislative instruments that limit the ability of the Member States to apply divergent rules.<sup>22</sup> The structure and roles of the EU's financial authorities have changed. The EU now has a set of agencies that have regulatory powers with respect to different aspects of financial regulation.<sup>23</sup>

At the beginning of the global financial crisis, the EU had a central bank, the ECB, with responsibilities for monetary policy within the eurozone area and holding a mandate to ensure price stability.<sup>24</sup> However, the ECB had limited powers to coordinate economic and fiscal policies within the EU and no powers to regulate banks. The system separated responsibilities for managing monetary policy within the eurozone and responsibilities for

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<sup>20</sup> *Id.* at 15 (“To prevent underestimation of risk for sovereign debt held in the banking book, the EBA set a floor on the sovereign risk parameters. . . . This . . . paves the way for a sound implementation of Basel standards in the European Union, moving away from the zero risk weight for sovereigns.”).

<sup>21</sup> Cf. Stijn Claessens et al., *The Political Economy of Basel II: The Costs for Poor Countries*, 31 *WORLD ECON.* 313, 314 (2008) (arguing that the Basel II capital adequacy regime was “formulated in a relatively exclusionary and closed policy community consisting of regulators and supervisors from the G10 leading industrial nations and their private sector interlocutors”).

<sup>22</sup> See, e.g., *Proposal for a Regulation of the European Parliament and of the Council on Prudential Requirements for Credit Institutions and Investment Firms*, at 8, COM (2011) 452 final (July 20, 2011) (“Shaping prudential requirements in the form of a Regulation would ensure that those requirements will be directly applicable to institutions. This would ensure a level-playing field by preventing diverging national requirements as a result of the transposition of a Directive. The proposed Regulation would clearly demonstrate that institutions follow the same rules in all EU markets, which would also boost confidence in the stability of institutions across the EU. A Regulation would also enable the EU to implement any future changes more quickly, as amendments can apply almost immediately after adoption. That would enable the EU to meet internationally agreed deadlines for implementation and follow significant market developments.”).

<sup>23</sup> Council Regulation 1093/2010, Establishing a European Supervisory Authority (European Banking Authority), 2010 O.J. (L 331) 12 (EU); Council Regulation 1095/2010, Establishing a European Advisory Authority (European Banking Authority), 2010 O.J. (L 331) 84 (EU); Council Regulation 1094/2010, Establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), 2010 O.J. (L 331) 48 (EU).

<sup>24</sup> See, e.g., HANSPETER K. SCHELLER, *THE EUROPEAN CENTRAL BANK: HISTORY, ROLE AND FUNCTIONS* 12 (2d rev. ed. 2006), available at <http://www.ecb.int/pub/pdf/other/ecbhistoryrolefunctions2006en.pdf> (“The ECB is also the embodiment of modern central banking: the overriding objective of its monetary policy is price stability.”).

financial regulation. However, the ECB's importance grew exponentially within months after the crises began to unravel. The ECB has been an important actor in the EU's response to the dual crises. In terms of the immediate response to the crises, the ECB plays a significant role in the EU's new European Systemic Risk Board, and provides liquidity to banks through the Long Term Refinancing Operation ("LTRO") program.<sup>25</sup> Now, the ECB is to become a banking regulator.<sup>26</sup> As a lender of last resort, the ECB needs to have powers to regulate the institutions that may look to it for support. In the future, banks—at least in the eurozone—may be European in life and in death. This development raises a number of questions ranging from technical issues about how the new system will work and whether the EU and eurozone can agree on the details to more general questions about the relationship between central banking and bank regulation and between bank regulation and the regulation of other financial firms.

An important feature of the EU has always been that it is as much a political as an economic union. Economic coordination was designed as an instrument to prevent conflict as much as it was an end in itself.<sup>27</sup> Monetary integration was identified as part of the European project very early on,<sup>28</sup> and the achievement of a single currency was seen as being important for political purposes to increase integration in Europe.<sup>29</sup> But the single currency was not bolstered by adequate controls over the fiscal policies of the eurozone Member States.<sup>30</sup> Enforcement of compliance with the Stability and Growth Pact

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<sup>25</sup> See, e.g., *LTRO: A User's Manual*, ZERO HEDGE (Feb. 13, 2012), <http://www.zerohedge.com/contributed/ltro-users-manual>.

<sup>26</sup> See, e.g., Towards a Genuine Economic and Monetary Union, *supra* note 13.

<sup>27</sup> See Robert Schuman, French Foreign Minister, The Schuman Declaration, Meeting of the Eur. Coal & Steel Cmty. (May 9, 1950), available at [http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index\\_en.htm](http://europa.eu/about-eu/basic-information/symbols/europe-day/schuman-declaration/index_en.htm) ("[T]here will be realised simply and speedily that fusion of interest which is indispensable to the establishment of a common economic system; it may be the leaven from which may grow a wider and deeper community between countries long opposed to one another by sanguinary divisions.").

<sup>28</sup> SCHELLER, *supra* note 24, at 15. Scheller identifies 1962 as the starting point for consideration of monetary integration in Europe:

[T]he most appropriate starting point would therefore seem to be the year 1962 . . . and a European Commission document known as the Marjolin Memorandum. This memorandum initiated the first discussion on monetary integration at the Community level and prompted the first, albeit very limited, measures in the field of monetary cooperation.

*Id.*

<sup>29</sup> See, e.g., David Marsh, *Faltering Ambitions and Unrequited Hopes: The Battle for the Euro Intensifies?*, 49 J. COMMON MKT. STUD. 45, 46 (2011).

<sup>30</sup> See, e.g., LUDGER SCHUKNECHT ET AL., THE STABILITY AND GROWTH PACT: CRISIS AND REFORM 9 (2011), available at <http://www.ecb.int/pub/pdf/scpops/ecbocp129.pdf> (noting that although the Member States agreed on a Stability and Growth Pact as a component of the institutional arrangements for the Euro, the "Pact's Achilles heel was its weak enforcement provisions"); INT'L MONETARY FUND [IMF], WORLD ECONOMIC OUTLOOK APRIL 2012: GROWTH RESUMING, DANGERS REMAIN, at 3 (Apr. 2012) [hereinafter IMF, WORLD ECONOMIC OUTLOOK], available at

criteria was notoriously weak.<sup>31</sup> As a result, Greece was able to manipulate its financial data.<sup>32</sup> The International Monetary Fund (“IMF”) has stated that the EU needs to have more effective mechanisms in place to ensure that members of the eurozone adopt responsible fiscal policies.<sup>33</sup> However, managing the adoption of sound economic governance in a multi-level regulatory environment is a complex matter, and politicians and central bankers need to be conscious of how different audiences will receive their statements.<sup>34</sup> As EU policymakers confront the issues of maintaining economic and financial stability in a context that is as political as it is technocratic, they face a situation which is more complex than that faced by technocratic regulators coordinating their actions in networks such as the Financial Stability Board (“FSB”). The EU’s larger context has allowed it to make more progress in harmonizing financial regulations than has been achieved in the broader international context, but managing the political aspects of harmonization is not simple. In developing new rules, whether in treaties or legislative measures, the Member States and EU institutions must consider the reactions of European citizens to the implications of the new rules.<sup>35</sup>

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<http://www.imf.org/external/pubs/ft/weo/2012/01/pdf/text.pdf> (“The Stability and Growth Pact was devised to bring about fiscal discipline but failed to forestall bad fiscal policies.”).

<sup>31</sup> SCHUKNECHT ET AL., *supra* note 30, at 10 (“[The 2005 reform] introduced greater discretion, leniency and political control into procedures. The strictness of the 3% limit and the time frame for correcting excessive deficits were relaxed, while procedural deadlines were extended. The greater complexity of the rules made monitoring by markets and the public more difficult.”).

<sup>32</sup> See, e.g., ORG. ECON. COOPERATION AND DEV. [OECD], OECD ECONOMIC SURVEYS: GREECE 2011, 4 (2011) [hereinafter OECD ECONOMIC SURVEYS: GREECE 2011], available at <http://www.oecd.org/eco/48462569.pdf> (“The dire economic situation was magnified by lost credibility as serious deficiencies in statistical monitoring of government accounts were exposed.”); see also Manos Matsaganis, *The Welfare State and the Crisis: The Case of Greece*, 21 J. EUR. SOC. POL’Y 501, 501 (2011) (“The revised figures stunned public opinion at home and shocked markets abroad.”).

<sup>33</sup> See IMF, WORLD ECONOMIC OUTLOOK, *supra* note 30, at 23 (“Over the medium term, many difficult decisions will be required to remedy EMU design flaws that contributed to the crisis . . . . A strong mechanism that delivers responsible fiscal policies is urgently needed.”).

<sup>34</sup> See, e.g., Jörg Asmussen, Member of the Exec. Bd. of the ECB, Speech at the European Communication Summit 2012, Building Trust in a World of Unknown Unknowns: Central Bank Communication Between Markets and Politics in the Crisis (July 6, 2012), transcript available at <http://www.ecb.int/press/key/date/2012/html/sp120706.en.html> (“In Spring 2010, Angela Merkel addressed the German Bundestag to persuade lawmakers to approve the financial assistance programme for Greece. She had to engage in a profoundly political discourse. She employed all tools of rhetoric. And she justified her appeal by declaring that ‘the future of the euro is at stake’. This was legitimate. However, in financial markets across the globe, that very same message popped up on traders’ screens as a one-liner: ‘Merkel questions survival of single currency.’ If you were a trader, what would you do? The rest is history. One and the same message is received very differently by different audiences. But those audiences cannot be separated easily. ‘Political’ communication and the processing of this information in nervous and fragile markets has been a major factor that exacerbated and propagated the crisis.”).

<sup>35</sup> Cf. Tobias Theiler, *Does the European Union Need to Become a Community?*, 50 J. COMMON MKT. STUD. 783, 795 (2012) (“Attempts to stabilize the EMU project by making its members still more mutually dependent and the Union still more intrusive and redistributive risk continuously



For many observers, the EU's response to the crises raises the recurrent issue about the extent to which decision making in the EU is and should be a democratic and transparent process that relies on the Community Method rather than a process of negotiation between the governments of the Member States at Summit Meetings.<sup>36</sup> This issue arises in the EU in a way that it does not when the Basel Committee adopts new standards for capital adequacy because, unlike the Basel Committee, the EU has the power to make rules that are formally binding on the Member States and on EU citizens, much as a domestic legislature does. Because of the crisis, European citizens in a number of states have experienced austerity measures that they may blame on the EU as much as on their own governments.

## II. THE GLOBAL FINANCIAL CRISIS AND SOVEREIGN DEBT CRISIS

In the summer of 2007, the financial markets noticed evidence of problems in the asset-backed securities markets when funds, which had invested in securities backed by U.S. subprime mortgages, froze redemptions.<sup>37</sup> A problem that originated in one area of financial activity spread as market participants lost confidence in their ability to value financial assets.<sup>38</sup> Financial institutions suffered losses and regulators intervened to provide support. For example, the Federal Reserve Board helped Bear Stearns merge with JPMorgan Chase in early 2008.<sup>39</sup> Central banks provided liquidity support to banks,<sup>40</sup> and states even acquired ownership interests in assets of financial institutions or in the institutions

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upporting the ante with public support for such measures demanding the very commitments to and trust in the currency's long-term viability the crisis has already helped undermine.”).

<sup>36</sup> See, e.g., Schulz Speech of April 25, 2012, *supra* note 9 (“In the past few months we have witnessed a disturbing trend towards renationalisation and ‘summitisation’: the Heads of State and Government are arrogating more and more decisions to themselves, debating and taking decisions behind closed doors and in disregard of the Community method.”).

<sup>37</sup> See, e.g., BANK FOR INT’L SETTLEMENTS, 78TH ANNUAL REPORT: 1 APRIL 2007–31 MARCH 2008, 3 (2008) (“The simmering turmoil in financial markets came to the boil on 9 August 2007. On that day, a number of central banks felt compelled to take extraordinary measures in an attempt to restore order in the interbank market. The disorder was triggered by a freeze on redemptions from a small number of funds that had invested in structured finance products backed by US subprime mortgages of recent vintage.”).

<sup>38</sup> See *id.* at 4 (“By early August, a combination of growing concerns about the valuations of complex products, liquidity risk and counterparty risk had led to a host of other markets being negatively affected. There was an effective collapse of the market for structured products based on mortgages, a massive withdrawal of investors from the asset-backed commercial paper market, and a sudden drying-up of interbank term money markets in the major currencies.”).

<sup>39</sup> *Id.* at 5.

<sup>40</sup> See, e.g., *id.* at 9–10 (“The Federal Reserve felt the need to be especially flexible. It successfully introduced a new facility to auction discount window credit, to address the stigma associated with the traditional use of the discount window. Moreover, after the assisted takeover of Bear Stearns, the Fed agreed to extend loans to primary dealers as part of its normal operations, although these firms are not commercial banks and, indeed, are not even supervised by the Federal Reserve System.”).

themselves. For example, the U.K. nationalized Northern Rock,<sup>41</sup> a bank that found it was unable to fund its mortgage loans in the market.<sup>42</sup>

Public support for financial institutions shifted the costs of financial failures to taxpayers.<sup>43</sup> The costs of financial bailouts put pressure on the public finances of many countries, which were already strained by other policy decisions<sup>44</sup> and declines in tax revenues during the crisis.<sup>45</sup> States implemented austerity measures, either at their own initiative,<sup>46</sup> or as a condition of borrowing.<sup>47</sup> Greece's debt burden became unsustainable, and it sought financial assistance from the EU and the IMF. The "Troika" of the Commission, ECB, and IMF imposed significant austerity measures on Greece,<sup>48</sup> and an EU Task Force for Greece began operating in Athens to

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<sup>41</sup> *Id.* at 10; The Northern Rock plc Transfer Order, 2008, S.I. 2008/432, pt. 2 (U.K.), available at [http://www.legislation.gov.uk/uksi/2008/432/pdfs/uksi\\_20080432\\_en.pdf](http://www.legislation.gov.uk/uksi/2008/432/pdfs/uksi_20080432_en.pdf).

<sup>42</sup> HOUSE OF COMMONS TREASURY COMMITTEE, THE RUN ON THE ROCK, FIFTH REPORT OF SESSION, 2007–8, H.C. 56–I, at 3 (U.K.) ("The directors of Northern Rock were the principal authors of the difficulties that the company has faced since August 2007. The directors pursued a reckless business model which was excessively reliant on wholesale funding.").

<sup>43</sup> See *Commission Proposal for a Council Decision Addressed to Spain on Specific Measures to Reinforce Financial Stability*, at 4, COM (2012) 406 final (July 16, 2012) ("As of April 2012, the total gross financial contribution by the Spanish State (excluding bond issuance guarantees) amounted to about EUR 34 billion (3.2% of GDP). The capital support was provided via the Fund for Orderly Bank Restructuring (FROB) endowed with a capital of EUR 15 billion, of which EUR 9 billion were already paid in. The State has also provided guarantees to bank senior bond issues amounting to about EUR 86 billion (out of this total, about EUR 58 billion guarantees are outstanding)."); see generally HM TREASURY, ANNUAL REPORT AND ACCOUNTS, 2011–12, H.C. 46 (U.K.).

<sup>44</sup> See, e.g., Douglas Sutherland et al., *Fiscal Consolidation: How Much, How Fast and by What Means?*, OECD ECON. POL. PAPERS 1, at 11 (Apr. 2012) (noting that for a number of countries the fiscal challenge arises from "future pension and health care spending pressures" as well as from the financial crisis).

<sup>45</sup> See, e.g., *id.* at 8.

<sup>46</sup> See, e.g., HM TREASURY, SPENDING REVIEW 2010, at 5, Cm. 7942 (U.K.) (2010) ("The Spending Review sets out how the Coalition Government will carry out Britain's unavoidable deficit reduction plan. This is an urgent priority to secure economic stability at a time of continuing uncertainty in the global economy and put Britain's public services and welfare system on a sustainable long term footing.").

<sup>47</sup> See IMF, IMF COUNTRY REPORT NO. 10/111, GREECE: REQUEST FOR STAND-BY ARRANGEMENT 8 (2010), available at <http://www.imf.org/external/pubs/ft/scr/2010/cr10111.pdf> (noting that Greece would, among other measures, implement pension reform, health reform, and tax reform); Council Recommendation to Greece of 16 February 2010 with a View to Ending the Inconsistency with the Broad Guidelines of the Economic Policies in Greece and Removing the Risk of Jeopardising the Proper Functioning of the Economic and Monetary Union, No. 190/2010 of 30 Mar. 2010, ¶ 1, 2010 O.J. (L 83) 67 (EU) ("Taking into account the institutional weaknesses of the Greek public finances and economy at large, Greece should design and implement, starting as soon as possible in 2010, a bold and comprehensive structural reforms package.").

<sup>48</sup> Cf. OECD ECONOMIC SURVEYS: GREECE 2011, *supra* note 32, at 5 ("Greece needs to modernise its economy by adopting structural reforms that move its public sector and labour and product markets closer to international best practice. Waste of public resources must end; tax evasion must be decisively attacked; public services need to improve and confidence needs to be restored between the Greek citizens and their government; employment of youth, women and seniors

“bolster the country’s administrative capacity and provide technical assistance.”<sup>49</sup> In return, Greece obtained financial support from the European Financial Stability Facility.<sup>50</sup> In addition, Ireland and Portugal also received support from the European Financial Stability Facility.<sup>51</sup> In 2012, Spain sought financial support from the EU to help sustain its financial institutions.<sup>52</sup> These developments made visible distinctions between what came to be described as the peripheral EU Member States that required financial support and those Member States that would be providing the support.<sup>53</sup>

As the crises developed, the Member States and the EU itself faced fundamental issues of social policy, management of economic policy, and financial regulation. Pension reform became a policy issue for the EU, partly because of demographic change, but also because of the financial problems in the eurozone.<sup>54</sup> The implementation of austerity measures meant that citizens tended to feel the cost of a bailout in terms of increased taxes and reduced government spending.<sup>55</sup> High unemployment levels contributed to

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should increase; effort, efficiency and innovation of workers should be encouraged and rewarded.”).

<sup>49</sup> *Agreement on a New Programme to Secure Greece’s Future in the Eurozone*, COUNCIL OF THE EUR. UNION (Feb. 21, 2012), <http://www.consilium.europa.eu/homepage/showfocus?lang=en&focusID=80910>.

<sup>50</sup> See, e.g., *European Financial Stability Facility*, EFSF NEWSLETTER (Eur. Fin. Stability Facility, Luxembourg, Lux.), June, 2012, available at <http://www.efsf.europa.eu/attachments/201206-efsf-newsletter-n05.pdf> (noting financial support to Greece, and that “[t]he crisis mechanism comes as a complement to the key elements for progress: the structural reforms and fiscal consolidation on the national level and the measures on the European level such as the fiscal compact, increased surveillance and pan-European supervisory bodies”).

<sup>51</sup> *Id.*

<sup>52</sup> See, e.g., *Proposal for a Council Decision Addressed to Spain on Specific Measures to Reinforce Financial Stability*, *supra* note 43, at 2 (“On 9 June, the Eurogroup was informed about Spanish authorities’ intention to apply for financial assistance to recapitalize its banking sector. The Eurogroup stated that it was willing to respond favourably to such a request and committed to granting Spain financial assistance, covering estimated capital requirements with an additional safety margin, estimated as summing up to EUR 100 billion in total.”).

<sup>53</sup> See, e.g., Mark Hallerberg, *Fiscal Federalism Reforms in the European Union and the Greek Crisis*, 12 EUR. UNION POL. 127, 128 (2011) (“The sovereign debt crisis in Greece in the spring of 2010 and, to a much lesser extent, in Ireland, Spain and Portugal seemed to change everything. It put significant pressure on the euro and on the governance structures of the euro zone. It also made clear the degree to which all countries in the euro zone are connected to one another. Budget decisions in one of the smallest economies in the euro zone had implications for all countries that have the euro.”).

<sup>54</sup> See, e.g., *Commission White Paper on an Agenda for Adequate, Safe and Sustainable Pensions*, at 3, COM (2012) 55 final (Feb. 16, 2012) (“Together, longevity growth and the transition into retirement of the baby-boomers will have far-reaching economic and budgetary consequences in the EU, reducing the economic growth potential and exercising pressure on public finances . . . the success of retirement reforms in the Member States is a major determining factor for the smooth functioning of the Economic and Monetary Union.”).

<sup>55</sup> See, e.g., JONATHAN CRIBB ET AL., INST. FOR FISCAL STUDIES, LIVING STANDARDS, POVERTY AND INEQUALITY IN THE UK: 2012, at 2 (2012), available at <http://www.ifs.org.uk/comms/comm124.pdf>

poverty.<sup>56</sup> However, unemployment levels vary between the EU's Member States. In March 2012, Austria had the lowest unemployment rate at 4 percent, while Spain had the highest at 23.3 percent.<sup>57</sup>

Thus, although the responses to the financial crisis and the sovereign debt crisis have involved discussions about complex financial transactions, the regulation and management policies of firms, and the technical conditions for financial support to financial institutions and the Member States, the crises have also affected European citizens, who are often left forgotten in this largely technical discussion. The EU's sovereign debt crisis is a major threat to the stability of the financial markets,<sup>58</sup> to the international economy,<sup>59</sup> to the EU itself,<sup>60</sup> and to the citizens who live there.

The crisis throws into sharp relief and intensifies features of the European Union that are perennial—though not always so critical. Structurally, the EU combines intergovernmental and supranational features. In the Council and the European Council, representatives of national governments meet together to agree on policies,<sup>61</sup> whereas other

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(“The fiscal tightening being implemented by the coalition government includes net tax rises and cuts to benefits, which will put further downward pressure on household incomes. Considering all these factors, recent forecasts by IFS researchers have suggested that median household income will continue to fall in real terms until 2013–14, and still be lower in 2015–16 than it was in 2002–03. If realised, this would represent the worst period for changes in median income since at least the early 1960s, and probably much earlier.”); cf. SUSAN HARKNESS ET AL., JOSEPH ROWNTREE FOUND, POVERTY: THE ROLE OF INSTITUTIONS, BEHAVIOURS AND CULTURE 3 (2012), available at <http://www.jrf.org.uk/sites/files/jrf/poverty-culture-behaviour-full.pdf> (noting a hardening of public attitudes to people living in poverty).

<sup>56</sup> See, e.g., *EU Employment and Social Situation*, SOC. EUR. Q. REV. (Eur. Comm., Brussels, Belg.), Mar. 2012, at 5, available at <http://ec.europa.eu/social/BlobServlet?docId=7548&langId=en> (noting that the “youth unemployment rate has reached a historic high in several countries and an unprecedented one of 22.4% in the EU in January 2012 (nearly 50% in Spain and Greece)”). Lower income groups suffered more from financial stress since the crisis than higher income groups. *Id.* at 27.

<sup>57</sup> *Id.* at 16.

<sup>58</sup> See, e.g., ECB, FINANCIAL STABILITY REVIEW: DECEMBER 2010, at 9 (2010), <http://www.ecb.int/pub/pdf/other/financialstabilityreview201012en.pdf> (“The main source of concern stems from the interplay between sovereign debt problems and vulnerabilities in segments of the euro area banking sector.”).

<sup>59</sup> See, e.g., Christine Lagarde, Managing Dir., IMF, Speech in Berlin, Global Challenges in 2012 (Jan. 23, 2012), transcript available at <http://www.imf.org/external/np/speeches/2012/012312.htm> (“[T]his is a defining moment. . . . It is about saving the world from a downward economic spiral. It is about avoiding a 1930s moment, in which inaction, insularity, and rigid ideology combine to cause a collapse in global demand. The longer we wait, the worse it will get. The only solution is to move forward together. Our collective economic future depends on it.”).

<sup>60</sup> See, e.g., Schulz Speech of April 25, 2012, *supra* note 9.

<sup>61</sup> See, e.g., James P. Cross, *Interventions and Negotiation in the Council of Ministers of the European Union*, 13 EUR. UNION POL. 47, 47–48 (2012) (“[I]t is in the Council where citizens’ domestic-level government representatives can make national policy positions known and thus influence the legislative process. Therefore, the relative influence that each member state can exert on the legislative process within the Council is of fundamental importance to the democratic legitimacy of the institution as a whole.”).

institutions of the EU have more of a supranational character. Citizens elect members of the European Parliament to represent their interests directly as part of the EU's legislative process, although disillusioned citizens may be less inclined to participate in EU elections.<sup>62</sup> Under the Treaties, members of the Commission and Judges on the Court of Justice and General Court are required to act independently of the states that nominate them. Even the Council has some supranational characteristics because it decides many policies by majority vote, which binds Member States to decisions that they may oppose. The EU's legislative process has developed over time so that the European Parliament, a supranational body, shares legislative power with the Council in most matters (i.e., the Community Method). However, at difficult times, such as during the financial and sovereign debt crises, the Member States have often chosen to meet in Summit Meetings to make important decisions.<sup>63</sup> The members of the European Parliament do not participate in these Summit Meetings. Thus, the Member States have at times responded to the crises in ways which have limited the ability of European citizens' directly elected representatives to participate.

When Martin Schulz became President of the European Parliament in early 2012, he recognized that European citizens were facing high levels of unemployment and increased poverty.<sup>64</sup> Furthermore, this led to a "crisis of confidence in politics and its institutions" that was "also undermining faith in the European integration process."<sup>65</sup> He noted that,

For months now the Union has been stumbling from one crisis summit to another. Decisions which affect us all are being taken by heads of government behind closed doors. To my mind, this is a reversion to a form of European politics which I thought had been consigned to the history books: it is reminiscent of the era of the Congress of Vienna in the 19th century, when Europe's leaders were ruthless in their defence

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<sup>62</sup> See, e.g., Daniel Stockemer, *Citizens' Support for the European Union and Participation in European Parliament Elections*, 13 EUR. UNION POL. 26, 42 (2012) ("[C]itizens' opinions about the EU matter for their participation in EP elections.").

<sup>63</sup> Cf. Scicluna, *supra* note 11, at 442 ("[T]he separation of the symbols and rhetoric of constitutional patriotism from EU treaty reform coincides with, and reinforces, a trend away from political and legal supranationalism.").

<sup>64</sup> Martin Schulz, President of the Eur. Parliament, Inaugural Speech Following His Election as President of the European Parliament (Jan. 17, 2012), *transcript available at* [http://www.europarl.europa.eu/the-president/en/press/press\\_release\\_speeches/speeches/sp-2012/sp-2012-january/speeches-2012-january-1.html](http://www.europarl.europa.eu/the-president/en/press/press_release_speeches/speeches/sp-2012/sp-2012-january/speeches-2012-january-1.html) ("As a result of the economic crisis, in many countries poverty is on the increase and unemployment has reached disastrous levels among young people in particular. They are now taking to Europe's streets to protest against an economic system which allows a small minority to rake in the profits when times are good, and forces society as a whole to bear the losses when times are bad; a system whose workings might lead a dispassionate observer to conclude that anonymous ratings agencies in New York are more powerful than democratically elected governments and parliaments.").

<sup>65</sup> *Id.*

of national interests and democratic scrutiny was simply unheard of.<sup>66</sup>

Martin Schulz is not alone in suggesting that the crises have undermined the Community Method and have led to intergovernmental agreements on the one hand and independent action by Member States on the other. members of the Commission, conversely, tell a different story, emphasizing the importance of the Community Method in resolving the crises.<sup>67</sup>

### III. RESPONSES TO THE CRISES

The EU's system of multilevel governance requires it to deal with questions about how powers to regulate different activities should be allocated between the EU institutions, the Member States, and sub-national authorities. But crises impose stresses on governments, on regional organizations like the EU, and on multilevel governance more generally. National governments, the EU institutions, and international financial institutions wished to act to maintain confidence in the international financial markets during the financial crisis and again during the EU's sovereign debt crisis. The EU and its Member States faced calls to cooperate with other jurisdictions and international financial institutions.<sup>68</sup> In both crises, domestic politics led the EU's Member States to focus on the domestic aspects of the crises and domestic solutions while treaty obligations and the G20 urged them to focus on cooperation with each other. The G20 called for international cooperation with respect to financial stability. It also called for prudential regulation and new harmonized standards on hedge funds and credit rating agencies and committed itself to "implement international financial standards (including the twelve key International Standards and Codes)."<sup>69</sup> The G20, although formed in 1999 to address issues of financial stability, is newly prominent as an actor in transnational financial regulation. The EU is part of the G20, and as the G20's work on financial stability (involving the FSB and the IMF) evolves, the EU is becoming more of a layer within a more complex multilevel system of financial regulation.

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<sup>66</sup> *Id.*

<sup>67</sup> See, e.g., Maroš Šefčovič, Vice-President, Eur. Comm'n Responsible for Interinstitutional Relations and Admin., Speech at the Institute of International and European Affairs: The Strength of the Community Method in Tackling the Crisis and the Role of the Lisbon Treaty (Feb. 17, 2012) ("I think it's fair to say that the fundamental lesson of the crisis is that of interdependence: now more than ever, we need greater integration to ensure that national economic and budgetary policies cannot again have such a devastating effect on the euro area and by extension the EU as a whole.").

<sup>68</sup> See, e.g., FIN. STABILITY FORUM, REPORT OF THE FINANCIAL STABILITY FORUM ON ENHANCING MARKET AND INSTITUTIONAL RESILIENCE 2 (2008), available at [www.financialstabilityboard.org/publications/r\\_0804.pdf](http://www.financialstabilityboard.org/publications/r_0804.pdf) ("While national authorities may continue to consider short-term policy responses should conditions warrant it, to restore confidence in the soundness of markets and institutions, it is essential that we take steps now to enhance the resilience of the global system.").

<sup>69</sup> See, e.g., G20 Declaration, *supra* note 5.

While the G20 has reacted to the global financial crisis by emphasizing the need for increased harmonization of standards for financial regulation at the international level, EU institutions have reacted to the crises by increasing EU level regulation of financial firms, financial markets, and the economic policies of the Member States.

Although at the beginning of the financial crisis the EU had a harmonized system of financial regulation in which banks and securities and insurance firms licensed in one state in the eurozone could carry on business throughout the EU based on their home state authorization,<sup>70</sup> harmonization of financial regulation was not complete.<sup>71</sup> Structurally, the EU's system of financial regulation relied on the sharing of competences between the Member States and EU institutions. The Lamfalussy Report, which set in motion dramatic changes to the EU's financial services regime,<sup>72</sup> recommended that EU securities regulation should comprise a system of framework rules, detailed implementation of rules and cooperation between regulators with respect to implementation of the EU rules and enforcement by the Commission.<sup>73</sup> The EU established a European Securities Committee composed of representatives of the Member States to advise the Commission on the policy issues and draft legislative proposals<sup>74</sup> and a Committee of European Securities Regulators ("CESR") composed of national regulators.<sup>75</sup>

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<sup>70</sup> See, e.g., Caroline Bradley, *Consumers of Financial Services and Multi-level Regulation in the European Union*, 31 *FORDHAM INT'L L.J.* 701, 706 (2008) ("Mutual recognition on the basis of minimum harmonized standards was designed to achieve a situation where a financial firm established in one Member State (its home State) would be allowed to supply services in other Member States and even establish offices in other Member States on the basis of its home State authorization to carry on business subject to home State rules.").

<sup>71</sup> *Initial Report of the Committee of Wise Men on the Regulation of European Securities Markets*, at 2 (Nov. 9, 2000), available at [http://ec.europa.eu/internal\\_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/initial-report-wise-men_en.pdf) ("An efficient European regulatory process for financial services and capital markets is crucial for the whole of the European Union and all its citizens. Crucial for successful economic reform, for boosting European economic growth. Crucial for helping channel the high rate of European savings towards the corporate sector. Crucial for strengthening both the international competitiveness of the European Union in the global economy and for releasing its entrepreneurial potential. Crucial also for job creation and consumer protection. There are major strategic, economic and social benefits to reap from an integrated European capital market.").

<sup>72</sup> See, e.g., Niamh Moloney, *The Lamfalussy Legislative Model: A New Era for the EC Securities and Investment Services Regime*, 52 *INT'L & COMP. L.Q.* 509, 509 (2003) ("[S]weeping changes have been made to the way in which EC securities and investment services measures are adopted.").

<sup>73</sup> *Final Report of The Committee of Wise Men on the Regulation of European Securities Markets*, at 19 (2001), available at [http://ec.europa.eu/internal\\_market/securities/docs/lamfalussy/wisemen/final-report-wise-men\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf).

<sup>74</sup> Commission Decision 2001/528, ¶ 6, 2001 O.J. (L 199) 45 (EC) ("The role of the Committee shall be to advise the Commission on policy issues as well as on draft legislative proposals the Commission might adopt in the field of securities."). This decision was subsequently amended to cover UCITs. Commission Decision 2004/8, ¶ 4, 2004 O.J. (L 3) 33 (EC).

<sup>75</sup> Commission Decision 2001/527, art. 2, 2001 O.J. (L 191) 43 (EC) ("The role of the Committee shall be to advise the Commission, either at the Commission's request, within a time limit which

The EU subsequently established other committees for banking<sup>76</sup> and insurance and occupational pensions.<sup>77</sup> CESR, the Committee of European Banking Supervisors (“CEBS”), and the Committee of European Insurance and Occupational Pensions Supervisors (“CEIOPS”) were transformed during the financial crisis into EU-level authorities with enhanced powers.<sup>78</sup> CESR became the European Securities and Markets Authority (“ESMA”);<sup>79</sup> CEBS became the European Banking Authority (“EBA”);<sup>80</sup> and CEIOPS became the European Insurance and Occupational Pensions Authority.<sup>81</sup> The EU has been centralizing regulatory supervision in some areas through these agencies. For example, the EBA has carried out stress tests “to assess the resilience of the banks involved in the exercise against an adverse but plausible scenario.”<sup>82</sup> ESMA has responsibility for registering and supervising credit rating agencies under the EU’s credit rating agency regulation.<sup>83</sup> But this regulatory centralization has not gone unchallenged:

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the Commission may lay down according to the urgency of the matter, or on the Committee’s own initiative, in particular for the preparation of draft implementing measures in the field of securities.”). This decision was subsequently amended to cover UCITs. Commission Decision 2004/7, 2004 O.J. (L 3) 32 (EC).

<sup>76</sup> Commission Decision 2004/10, 2004 O.J. (L 3) 36 (EC); Commission Decision 2004/5, 2004 O.J. (L 3) 28 (EC).

<sup>77</sup> Commission Decision 2004/9, 2004 O.J. (L 3) 34 (EC); Commission Decision 2004/5, 2004 O.J. (L 3) 30 (EC).

<sup>78</sup> Cf. THE DE LAROSIÈRE GROUP, THE HIGH-LEVEL GROUP ON FINANCIAL SUPERVISION IN THE EU (2009), available at [http://ec.europa.eu/internal\\_market/finances/docs/de\\_larosiere\\_report\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf) (proposing reforms).

<sup>79</sup> See Council Regulation 1095/2010, *supra* note 23; *ESMA in Short*, EUR. SEC. & MKTS. AUTH., <http://www.esma.europa.eu/page/esma-short> (last visited Mar. 16, 2013).

<sup>80</sup> See Council Regulation 1093/2010, *supra* note 23; *About Us*, EUR. BANKING AUTH., <http://www.eba.europa.eu/Aboutus.aspx> (last visited Mar. 16, 2013).

<sup>81</sup> See Council Regulation 1094/2010, *supra* note 23; *About EIOPA*, EUR. INS. & OCCUPATIONAL PENSIONS AUTH., <https://eiopa.europa.eu/about-eiopa/index.html> (last visited Feb. 17, 2013).

<sup>82</sup> Press Release, Eur. Banking Auth., Results of the 2011 EU-Wide Stress Test (July 15, 2011), available at <http://stress-test.eba.europa.eu/pdf/2011+EU-wide+stress+test+results+-+press+release+-+FINAL.pdf>. The stress tests did not succeed in enhancing confidence in EU banks as much as the EBA had hoped. See EUR. BANKING AUTH., ANNUAL REPORT 4 (2011) [hereinafter EBA ANNUAL REPORT 2011], available at [http://www.eba.europa.eu/cebs/media/Publications/Other%20Publications/Annual%20report/EBA2012\\_online\\_final2.pdf](http://www.eba.europa.eu/cebs/media/Publications/Other%20Publications/Annual%20report/EBA2012_online_final2.pdf) (“A key component of the Risk Analysis activities in 2011 was the EU-wide stress test exercise which was performed on a sample of 91 banks using a single adverse scenario and consistent methodology. This exercise has proven to be a very strong incentive for the banks involved as they took considerable actions to avoid falling below the benchmark of 5% CT1 and raised some EUR 50 bn in fresh capital in the first four months of 2011 in anticipation of meeting the commonly agreed capital threshold. Despite its success also in terms of great disclosure and quality assurance, the main objective of restoring confidence in the European banking sector was not achieved, as the sovereign debt crisis extended to more countries.”).

<sup>83</sup> See Council Regulation 513/2011, 2011 O.J. (L 145) 30 (EU) (noting that the Regulation makes ESMA “exclusively responsible for the registration and supervision of credit rating agencies in the Union”). For the original regulation, see Council Regulation 1060/2009, 2009 O.J. (L 302) 1 (EC).



the U.K. has questioned the validity of the EU's delegation of authority to ESMA with respect to short selling and credit default swaps.<sup>84</sup>

When the crisis hit, there were differences in the content of rules of financial regulation in different Member States: for example, deposit guarantees varied from one state to another.<sup>85</sup> And the EU had not agreed on harmonized rules for rescuing financial institutions in distress<sup>86</sup> or on addressing volatility caused by short selling.<sup>87</sup> The Commission has proposed new rules in a number of different areas to address perceived weaknesses in EU financial regulation.<sup>88</sup>

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<sup>84</sup> See, e.g., SHEARMAN AND STERLING LLP, SELLING THEMSELVES SHORT: EU ENACTS REGULATION BANNING NAKED SHORT SALES AND SOVEREIGN DEBT CDS 6 (2012), available at <http://www.shearman.com/Selling-Themselves-Short-EU-Enacts-Regulation-Banning-Naked-Short-Sales-and-Sovereign-Debt-CDS-05-01-2012/>; Council Regulation 236/2012, 2012 O.J. (L 86) 1 (EU).

<sup>85</sup> See, e.g., *Proposal for a Directive of the European Parliament and of the Council Amending Directive 94/19/EC on Deposit Guarantee Schemes as Regards the Coverage Level and the Payout Delay*, ¶ 5.2, COM (2008) 661 final (Oct. 15, 2008) (“The current Directive allows an optional co-insurance of up to 10%, i.e. a certain percentage of losses that is borne by the depositor. This has proven counterproductive for the confidence of depositors and may have exacerbated the problems. The argument of moral hazard (depositors should be ‘punished’ if they deposit their funds at a bank offering high interest rates but incurring high risks) is not tenable since retail depositors cannot, in general, judge the financial soundness of their bank. Consequently, this option should be discontinued.”); cf. Sebastian Schich, *Financial Crisis: Deposit Insurance and Related Financial Safety Net Aspects*, 95 OECD J.: FIN. MKT. TRENDS (2008).

<sup>86</sup> See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice, and the European Central Bank, An EU Framework for Cross-Border Crisis Management in the Financial Sector*, at 2, COM (2009) 561 final (Oct. 20, 2009) (“The recent crisis has exposed the EU’s lack of an effective crisis management for cross-border financial institutions. In autumn 2008, Member States agreed to take the necessary action to recapitalize and guarantee banks, and this unprecedented action was coordinated at European level on an ad-hoc basis. The measures were necessary in the exceptional conditions that afflicted the financial system.”).

<sup>87</sup> Council Regulation 236/2012, *supra* note 84, at 1 (“At the height of the financial crisis in September 2008, competent authorities in several Member States and supervisory authorities in third countries such as the United States of America and Japan adopted emergency measures to restrict or ban short selling in some or all securities. They acted due to concerns that at a time of considerable financial instability, short selling could aggravate the downward spiral in the prices of shares, notably in financial institutions, in a way which could ultimately threaten their viability and create systemic risks. The measures adopted by Member States were divergent as the Union lacks a specific common regulatory framework for dealing with short selling issues.”).

<sup>88</sup> See *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the European Central Bank, Regulating Financial Services for Sustainable Growth*, at 2, COM (2010) 301 final (June 2, 2010) (noting that “the Commission has been working to complete a comprehensive financial reform to address short-termism, poor risk management and a lack of responsibility of certain actors in the financial sector and to correct the underlying weaknesses in the supervisory and regulatory framework” and that progress had been made but that the Commission would “present the vast majority of the remaining regulatory reform proposals to the Council and European Parliament by the end of the year”).

The Commission adapted the EU's state aid rules (which are meant to prevent the Member States interfering with competition by subsidizing local industries) to allow the Member States to rescue failing, and even fundamentally sound, financial institutions promptly while not undermining the state aid rules.<sup>89</sup> Although the Commission adopted its guidelines to allow the Member States to act to rescue financial institutions quickly, the need for rescues of financial institutions persisted into 2012.<sup>90</sup> The Commission worked on developing an EU crisis management framework for banks<sup>91</sup> and published a proposed Directive in June 2012.<sup>92</sup>

The EU's response to the global financial crisis intensified EU level financial regulation by shifting some supervisory powers from national to EU authorities and developing increasingly demanding rules of financial regulation. Although intensifying financial regulation was designed in part to promote confidence in EU financial institutions,<sup>93</sup> rescues were necessary, and the EU loosened the competition law constraints which might have impeded the Member States' ability to rescue their own troubled financial institutions. However, the cost of rescuing troubled financial firms helped to put pressure on strained public finances and led to the sovereign debt crisis.<sup>94</sup> Of course, the sovereign debt crisis also grew out of a system of monetary

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<sup>89</sup> See *Communication from the Commission on the Application of State Aid Rules to Measures Taken in Relation to Financial Institutions in the Context of the Current Global Financial Crisis*, COM (2008) 6045 final (Oct. 13, 2008). The Commission acknowledged that it would be necessary to act quickly to protect the financial markets. *Id.* at 9 ("In applying these criteria to measures taken by Member States, the Commission will proceed with the swiftness that is necessary to ensure legal certainty and to restore confidence in financial markets."). See also Michael Reynolds et al., *EU Competition Policy in the Financial Crisis: Extraordinary Measures*, 33 *FORDHAM INT'L L.J.* 1670, 1689 (2011) ("The Commission has attempted to find a middle way between states clamoring for the power to rescue their most important financial institutions and legal purists decrying an apparent chasm between the existing state aid rules and the practice of the Commission.").

<sup>90</sup> *Communication from the Commission on the Application, from 1 January 2012, of State Aid Rules to Support Measures in Favour of Banks in the Context of the Financial Crisis*, ¶ 3, COM (2011) 8744 final (Dec. 1, 2011) ("The exacerbation of tensions in sovereign debt markets that has taken place in 2011 has put the banking sector in the Union under increasing pressure, particularly in terms of access to term funding markets. The 'banking package' agreed by the Heads of State or Government at their meeting of 26 October 2011 aims to restore confidence in the banking sector . . . . Despite those measures, the Commission considers that the requirements for State aid to be approved pursuant to Article 107(3)(b) will continue to be fulfilled beyond the end of 2011.").

<sup>91</sup> See, e.g., COM (2009) 561 final, *supra* note 86; *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions, and the European Central Bank, An EU Framework for Crisis Management in the Financial Sector*, COM (2010) 579 final (Oct. 20, 2010).

<sup>92</sup> *Proposal for a Directive of the European Parliament and of the Council Establishing a Framework for the Recovery and Resolution of Credit Institutions and Investment Firms*, COM (2012) 280 final (June 6, 2012).

<sup>93</sup> Cf. EBA ANNUAL REPORT 2011, *supra* note 82.

<sup>94</sup> See, e.g., Dorn, *supra* note 2.

union that imposed inadequate controls on the states participating in it because it was conceived of as a political, rather than an economic, project.<sup>95</sup> Some eurozone states had weak public finances even before the financial crisis.<sup>96</sup> But the sovereign debt crisis and the financial crisis reinforce each other because banks hold the sovereign debt of EU Member States<sup>97</sup> and have participated in credit default swaps with respect to sovereign debt.<sup>98</sup> EU bank regulation allowed sovereign risk to infect banks because the rules allowed banks to invest in sovereign debt in reliance on sovereign credit ratings without making their own independent assessments of the risks associated with those investments.<sup>99</sup> And the concerns about the reliability of credit ratings, which led to new EU rules on credit rating agencies,<sup>100</sup> were not initially generalized to sovereign ratings. Political imperatives to rescue failing financial institutions allowed the banks to infect sovereign debt, making it harder for sovereigns to borrow. Strategies adopted to resolve the crisis created new risks. For example, Greece's retroactive introduction of collective action clauses into Greek law-governed debt—allowing a restructuring to be imposed on dissenting creditors—was seen as having implications for the ability of other eurozone sovereigns to borrow.<sup>101</sup> The International Swaps and Derivatives Association announced that Greece's exercise of collective action clauses constituted a Restructuring Credit Event for the purposes of credit default swap transactions relating to Greece.<sup>102</sup>

The EU sovereign debt crisis illustrates that, whereas national governments are tempted to act to protect domestic interests in times of crisis, the EU's Member States are interdependent rather than independent.<sup>103</sup> The states within the eurozone are clearly connected by a single currency, but EU states outside the eurozone are also bound by their

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<sup>95</sup> See, e.g., Marsh, *supra* note 29.

<sup>96</sup> See, e.g., Peter Praet, Member of the Exec. Bd. of the ECB, Speech at the International Center for Monetary and Banking Studies: Monetary Policy at Crisis Times (Feb. 20, 2012), *transcript available at* <http://www.ecb.int/press/key/date/2012/html/sp120220.en.html>.

<sup>97</sup> See, e.g., ECB, ANNUAL REPORT 2010, at 138 (2011) (“[C]oncerns about the interplay between sovereign debt problems and banking sector vulnerabilities in some euro area countries reemerged in the second half of the year.”).

<sup>98</sup> See, e.g., Peter Eavis, *Greek Crisis Raises New Fears over Credit-Default Swaps*, N.Y. TIMES, Feb. 21, 2012, <http://dealbook.nytimes.com/2012/02/21/greek-crisis-raises-new-fears-over-credit-default-swaps/?src=me&ref=business>.

<sup>99</sup> See, e.g., Hannoun, *supra* note 17.

<sup>100</sup> See Council Regulation 513/2011, *supra* note 83.

<sup>101</sup> See, e.g., Matina Stevis & Katy Burne, *Greek Legal Maneuvers Raise Fears of Euro-Zone Debt Fallout*, WALL ST. J.: THE EURO CRISIS (Feb. 23, 2012, 4:54 AM), <http://blogs.wsj.com/eurocrisis/2012/02/23/greek-legal-maneuvers-raise-fears-of-euro-zone-debt-fallout/>.

<sup>102</sup> Int'l Swaps & Derivatives Ass'n [ISDA], *Determinations Committee Decision: Has a Restructuring Credit-Event Occurred with Respect to The Hellenic Republic?*, at 5, Issue Number 2012030901 (Mar. 9, 2012).

<sup>103</sup> See, e.g., Šefčovič, *supra* note 67.

links with the other EU Member States. The Member States are required under Article 121 of the Treaty on the Functioning of the European Union (“TFEU”) to “regard their economic policies as a matter of common concern,” and they are required to avoid excessive deficits under Article 126 TFEU.<sup>104</sup> States in the eurozone are subject to greater constraints. In the past, these constraints have often seemed more theoretical than real, which has been recognized for some time as an essential weakness of economic and monetary union in the EU.<sup>105</sup> The EU has now been forced to reinforce its economic governance,<sup>106</sup> although it is not clear that the new controls will be sufficient to resolve the crisis. The reinforcement of economic governance involves measures which are being implemented via the Community Method, and new treaties.

In November 2011, the EU agreed on a reinforced Stability and Growth Pact, known as the six-pack because it comprises five regulations and a directive, which entered into force the following December.<sup>107</sup> The Commission proposed an additional two-pack in November 2011,<sup>108</sup> and also published a Green Paper proposing that the members of the eurozone be empowered to issue Stability Bonds.<sup>109</sup> But joint issuance of bonds by members of the eurozone would require strong fiscal discipline.<sup>110</sup> The EU and the eurozone are working on developing stronger fiscal discipline through a treaty among the eurozone members on the European Stability

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<sup>104</sup> Consolidated Version of the Treaty on the Functioning of the European Union art. 126, Sept. 5, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU].

<sup>105</sup> See, e.g., SCHUKNECHT ET AL., *supra* note 30.

<sup>106</sup> See, e.g., Press Release, Eur. Comm’n, Commission Proposes to Suspend €495 Million of Cohesion Fund for Hungary for 2013 for Failure to Address Excessive Deficit (Feb. 22, 2012), available at [http://europa.eu/rapid/press-release\\_IP-12-161\\_en.htm](http://europa.eu/rapid/press-release_IP-12-161_en.htm).

<sup>107</sup> See, e.g., Press Release, Eur. Comm’n, EU Economic Governance “Six-pack” Enters into Force (Dec. 12, 2011), available at [http://europa.eu/rapid/press-release\\_MEMO-11-898\\_en.htm](http://europa.eu/rapid/press-release_MEMO-11-898_en.htm). See also Council Regulation 1173/2011, 2011 O.J. (L 306) 1; Council Regulation 1174/2011, 2011 O.J. (L 306) 8; Council Regulation 1175/2011, 2011 O.J. (L 306) 2; Council Regulation 1176/2011, 2011 O.J. (L 306) 25; Council Regulation 1177/2011, 2011 O.J. (L 306) 33; Council Directive 2011/85/EU, art. 126(14), 2011 O.J. (L 306) 41.

<sup>108</sup> *Commission Proposal for a Regulation on Common Provisions for Monitoring and Assessing Draft Budgetary Plans and Ensuring the Correction of Excessive Deficit of the Member States in the Euro Area*, COM (2011) 821 final (Nov. 23, 2011); see *Commission Proposal for a Regulation on the Strengthening of Economic and Budgetary Surveillance of Member States Experiencing or Threatened with Serious Difficulties with Respect to Their Financial Stability in the Euro Area*, COM (2011) 819 final (Nov. 23, 2011).

<sup>109</sup> See *Commission Green Paper on the Feasibility of Introducing Stability Bonds*, COM (2011) 818 final (Nov. 23, 2011).

<sup>110</sup> See, e.g., Stijn Claessens et al., *Paths to Eurobonds 6* (IMF, IMF Working Paper No. WP/12/172, 2012), available at <http://www.imf.org/external/pubs/ft/wp/2012/wp12172.pdf> (“[T]he possibility of transfers raises questions about moral hazard and the viability of any common debt proposal crucially depends on the ability to reduce and control it. The stronger the safety net and the larger the transfers, the greater is the concern that some countries may free ride. Common debt issuance thus requires powerful mechanisms to enforce fiscal discipline in a time-consistent manner.”).

Mechanism,<sup>111</sup> and a treaty on Stability, Coordination and Governance in the Economic and Monetary Union,<sup>112</sup> to which all EU Member States except the United Kingdom and the Czech Republic are parties.<sup>113</sup> As a matter of formal legal rules, EU Member States face new levels of control of their domestic economic management. But the EU's history demonstrates that strong rules are not enough: enforcement of the rules is also crucial.

The EU's sovereign debt crisis raises particular issues with respect to financial stability within the eurozone. But financial stability has also developed more generally as a significant issue in financial regulatory policy at the international level, within the EU, and in the governments of the EU Member States because of the financial crisis. The Financial Stability Forum, which was established a decade earlier to address issues of financial stability, became the Financial Stability Board.<sup>114</sup> At the domestic level, governments began to build a concern for financial stability into financial regulation.<sup>115</sup> The EU established a European Systemic Risk Board ("ESRB"),<sup>116</sup> which was to be chaired by the President of the ECB for the first five years.<sup>117</sup> The

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<sup>111</sup> Treaty Establishing the European Stability Mechanism, Feb. 2, 2012, available at <http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf>. The Treaty is adopted pursuant to Art 48(6) TEU, which "allows the European Council, acting by unanimity after consulting the European Parliament, the Commission and, in certain cases, the [ECB], to adopt a decision amending all or part of the provisions of Part Three of the [TFEU]." Council Decision 2011/199, 2011 O.J. (L 91) 1. The Decision was scheduled to come into force on January 1, 2013, if ratified by the Member States. *Id.* art. 2.

<sup>112</sup> Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Jan. 31, 2012, available at <http://www.european-council.europa.eu/media/579087/treaty.pdf>.

<sup>113</sup> See, e.g., EUROPEAN UNION COMMITTEE, THE EURO AREA CRISIS, 2010–12, H.L. 260, at 5 (U.K.) ("The proposed 'fiscal compact' and economic policy coordination measures for the euro area have been highly controversial. In December 2011 the United Kingdom indicated it would stand aside, and at the end of January 2012 the Czech Republic stated that it would not participate for the time being. Eight of the ten non-euro Member States are likely to join the 17 euro area states in signing the new treaty at the next European Council on 1–2 March 2012. The proposed treaty makes clear that the key provisions apply only to euro area states (unless a non-euro state indicates that it will choose to be bound by them).")

<sup>114</sup> See, e.g., Enrique R. Carrasco, *The Global Financial Crisis and the Financial Stability Forum: The Awakening and Transformation of an International Body*, 19 TRANSNAT'L L. & CONTEMP. PROBS. 203 (2010).

<sup>115</sup> HM TREASURY, A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM, 2011, Cm. 8012, at 4 (U.K.) ("[A] new Financial Policy Committee (FPC) will be established in the Bank of England, with responsibility for 'macro-prudential' regulation, or regulation of stability and resilience of the financial system as a whole.")

<sup>116</sup> Council Regulation 1092/2010, 2010 O.J. (L 331) 1 [hereinafter ESRB Regulation]; see also EUR. SYSTEMATIC RISK BD. [ESRB], <http://www.esrb.europa.eu/home/html/index.en.html> (last visited Mar. 16, 2013).

<sup>117</sup> ESRB Regulation, *supra* note 116, art. 5; see also Council Regulation 1096/2010, art. 1, 2010 O.J. (L 331) 162. Willem Buiters, commenting on the proposal for the ESRB, wrote that it was "ludicrously lopsided in favour of central banks in general and of the ECB in particular." Willem Buiters, *The Proposed European Systemic Risk Board Is Overweight Central Bankers*, WILLEM BUITER'S MAVERECON (Oct. 28, 2009, 12:34 AM), <http://blogs.ft.com/maverecon/2009/10/the-proposed-european-systemic-risk-board-is-overweight-central-bankers/#axzz1nAN1lhkg>.

Regulation establishing the ESRB made clear that the ESRB was to cooperate with the IMF and FSB<sup>118</sup> and also had responsibility for issuing warnings and recommendations to the EU, to individual Member States, and to the European Supervisory Authorities and national regulators.<sup>119</sup> The ESRB was to function in part as a mechanism for implementing international financial stability standards in the EU. The ESRB has published recommendations on how the Member States should define the objective of macro-prudential policy, on institutional arrangements for the Member States' measures with respect to financial stability, and on the need for transparency and accountability.<sup>120</sup> The ESRB emphasized that the national authorities responsible for macro-prudential policy should be "as a minimum operationally independent, in particular from political bodies and from the financial industry."<sup>121</sup> The ESRB's model of how to address financial stability is clearly a technocratic model, based on expertise, and insulated from politics. The ESRB has also issued recommendations on foreign currency lending,<sup>122</sup> and on U.S. dollar denominated funding of credit institutions.<sup>123</sup> Within the EU's legal system, recommendations are not binding, so the effectiveness of the ESRB's work depends on the Member States' willingness to give effect to the recommendations.<sup>124</sup> In addition to generating non-

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<sup>118</sup> ESRB Regulation, *supra* note 116, ¶ (7) ("The ESRB should draw expertise from a high-level scientific committee and take on all the global responsibilities required in order to ensure that the voice of the Union is heard on issues relating to financial stability, in particular by cooperating closely with the International Monetary Fund (IMF) and the Financial Stability Board (FSB), which are expected to provide early warnings of macro-prudential risks at the global level, and the partners of the Group of Twenty (G-20).").

<sup>119</sup> *Id.* ¶ (17) ("The ESRB should issue warnings and, where it deems necessary, recommendations either of a general or a specific nature, which should 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 with a specified timeline for the relevant policy response.").

<sup>120</sup> *Recommendation of the European Systemic Risk Board on the Macro-Prudential Mandate of National Authorities*, 2012 O.J. (C 41) 1, available at [http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB\\_2011\\_3.en.pdf](http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_3.en.pdf).

<sup>121</sup> *Id.* at Recommendation E.

<sup>122</sup> *Recommendation of the European Systemic Risk Board of 21 September 2011 on Lending in Foreign Currencies*, 2011 O.J. (C 342) 1, available at [http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB\\_2011\\_1.en.pdf](http://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_1.en.pdf).

<sup>123</sup> *See Recommendation of the European Systemic Risk Board of 22 December 2011 on US Dollar Denominated Funding of Credit Institutions*, 2012 O.J. (C 72) 1, available at [http://www.esrb.europa.eu/pub/pdf/ESRB\\_Recommendation\\_on\\_USD\\_Funding.pdf](http://www.esrb.europa.eu/pub/pdf/ESRB_Recommendation_on_USD_Funding.pdf).

<sup>124</sup> Jean-Claude Trichet wrote that "[t]he establishment of the European Systemic Risk Board (ESRB) on 16 December 2010 marked a major milestone in terms of Europe learning lessons from the crisis." ECB, ANNUAL REPORT 2010, *supra* note 97, at 11. It may be difficult for addressees to ignore its recommendations and warnings. Frank Dierick et al., *The ESRB at Work – Its Role, Organisation and Functioning*, in MACRO-PRUDENTIAL COMMENTARIES, at 4 (ESRB, Macro-prudential Commentaries, No. 1, 2012), available at [http://www.esrb.europa.eu/pub/pdf/commentaries/ESRB\\_commentary\\_1202.pdf](http://www.esrb.europa.eu/pub/pdf/commentaries/ESRB_commentary_1202.pdf) ("[T]he process leading to the adoption of warnings and recommendations and their communication involves collective consideration by a set of

binding recommendations, the ESRB contributes comments to consultations on financial regulatory policy initiated by the Commission<sup>125</sup> and thus may have an impact on the development of binding rules.

During the crises, the ECB has been actively providing European banks with liquidity support under its LTRO program.<sup>126</sup> After Mario Draghi took over at the ECB, the ECB extended the period for which support is available and relaxed the conditions for collateral eligibility. The aim of the program is to provide funding for banks while they are unable to raise funds through normal market channels with the hope that at some point they will be able to return to the markets for funding. But some commentators worry about whether banks will become too reliant on this source of funding and whether banks which received money in the LTRO program have invested the funds in high interest (and risky) sovereign debt.<sup>127</sup> Banks which invested LTRO funds in sovereign debt were not lending money to businesses<sup>128</sup> and not encouraging economic growth. Reliance on funding from the ECB provides a temporary solution to support banks in difficulty. Weaning banks off this support will be difficult, but necessary.<sup>129</sup>

The ECB characterized its role as a central bank as including a need to monitor financial system stability before the recent crises,<sup>130</sup> and the ECB is a member of the FSB. The ECB has the right under the TFEU to be consulted with respect to EU measures in its field of competence and also on draft national measures which relate to its competence.<sup>131</sup> This means that the

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important bodies and institutions, which makes it difficult for the addressees to simply ignore them.”).

<sup>125</sup> See, e.g., ESRB, THE ESRB'S REPLY TO THE EUROPEAN COMMISSION'S GREEN PAPER ON SHADOW BANKING (2012), available at [http://www.esrb.europa.eu/shared/pdf/2012-05-30\\_ESRB\\_reply.pdf](http://www.esrb.europa.eu/shared/pdf/2012-05-30_ESRB_reply.pdf).

<sup>126</sup> See, e.g., *LTRO: A User's Manual*, supra note 25.

<sup>127</sup> See Mary Watkins et al., *Forecast Demand for ECB Loans Scaled Back*, FIN. TIMES, Feb. 24, 2012, at 33.

<sup>128</sup> See, e.g., Mario Draghi, President of the ECB, Address at the Day in Memory of Federico Caffè, Sapienza Univ., Rome: A Route for Europe (May 24, 2012), transcript available at [http://www.ecb.int/press/key/date/2012/html/sp120524\\_1.en.html](http://www.ecb.int/press/key/date/2012/html/sp120524_1.en.html) (“Such operations have reinforced the perverse link between banks and sovereign debtors and may be considered a violation of the prohibition of financing public debt with central bank money, laid down in Article 123 of the Treaty. And, the opposite—but conceptually equivalent—criticism that these operations did not provide the economy with finance.”).

<sup>129</sup> See, e.g., BANK FOR INT'L SETTLEMENTS, 82ND ANNUAL REPORT: 1 APRIL 2011–31 MARCH 2012, at x (2012) (“The long-term objective of policy must be to pave the way to a robust business model of banking featuring strong and transparent balance sheets, self-sustaining international operations, and stable profits that do not rely on official support.”).

<sup>130</sup> See, e.g., ECB, EU BANKING SECTOR STABILITY (2003), available at <http://www.ecb.int/pub/pdf/other/eubksectorstability2003en.pdf>.

<sup>131</sup> Article 127(4) TFEU provides:

The European Central Bank shall be consulted: on any proposed Union act in its fields of competence, by national authorities regarding any draft

ECB expresses its opinions on a wide range of domestic and EU-level measures which relate to the financial system. The ECB's role in these consultations is an advisory one. In practice the other EU institutions<sup>132</sup> and the Member States may not consult the ECB sufficiently far in advance for the consultation to be effective.<sup>133</sup> But the ECB iterates and reiterates its preoccupations in its opinions on EU and national measures. For example, the ECB emphasizes that responses to the crisis should be collective rather than unilateral.<sup>134</sup> Opinions of the ECB cite with approval proposed measures that are consistent with views the ECB had expressed on earlier proposals.<sup>135</sup>

The ECB has a range of powers, from the hard coercive powers it enjoys in the context of coordinating financial support with sovereign debtors to

legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 129(4). The European Central Bank may submit opinions to the appropriate Union institutions, bodies, offices or agencies or to national authorities on matters in its fields of competence.

TFEU, *supra* note 104, art. 127(4). Article 282(5) provides that “[w]ithin the areas falling within its responsibilities, the European Central Bank shall be consulted on all proposed Union acts, and all proposals for regulation at national level, and may give an opinion.” *Id.* art. 282.5; see also Council Decision 98/415, 1998 O.J. (L 189) 42 (EC).

<sup>132</sup> See, e.g., *Opinion of the European Central Bank on a Proposal for a Directive on the Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms and a Proposal for a Regulation on Prudential Requirements for Credit Institutions and Investment Firms*, 2012 O.J. (C 105) 1, 3, available at [http://www.ecb.int/ecb/legal/pdf/c\\_10520120411en00010036.pdf](http://www.ecb.int/ecb/legal/pdf/c_10520120411en00010036.pdf) (“[I]n order to deploy the full benefits of the exercise by the ECB of its advisory role, the ECB should be consulted in due time on any draft Union acts, including draft delegated and implementing acts, falling within its fields of competence.”).

<sup>133</sup> See, e.g., *Opinion of the European Central Bank of 20 February 2012 on State Guarantees*, at 2, CON/2012/13 (Feb. 20, 2012), available at [http://www.ecb.int/ecb/legal/pdf/en\\_con\\_2012\\_13.pdf](http://www.ecb.int/ecb/legal/pdf/en_con_2012_13.pdf) (noting that “[t]he consultation request was submitted on 27 January, and the consulting authority requested the ECB to consider the consultation as a matter of urgency, without however setting a time limit. On 1 February, without further notice, the draft order was adopted and published in the Boletín Oficial del Estado including an annex on the fee structure that had not been included in the draft text submitted to the ECB. In this context, the ECB would like to remind the Spanish authorities that, according to Article 4 of Decision 98/415/EC, the ECB must be consulted at an appropriate stage enabling the authority initiating the draft legislative provision to take into consideration the ECB's opinion before taking its decision on the substance. Furthermore, it should be ensured that the ECB is able to perform its advisory role in an appropriate manner by making available the full draft text to it”).

<sup>134</sup> See, e.g., *Opinion of the European Central Bank of 24 January 2012 on Measures for the Stabilisation of the Financial Market*, at 3, CON/2012/2 (Jan. 24, 2012), available at [http://www.ecb.europa.eu/ecb/legal/pdf/en\\_con\\_2012\\_2\\_f\\_sign.pdf](http://www.ecb.europa.eu/ecb/legal/pdf/en_con_2012_2_f_sign.pdf) (“In line with its previous opinions, the ECB emphasises that when adopting measures to deal with the financial crisis, Member States should act in a coordinated manner.”).

<sup>135</sup> See, e.g., *Opinion of the European Central Bank of 12 December 2011 on the Establishment and Financing of a Resolution Fund and on the Amended Calculation of Contributions to the Deposit Guarantee Scheme*, at 4, CON/2011/103 (Dec. 12, 2011), available at [http://www.ecb.int/ecb/legal/pdf/en\\_con\\_2011\\_103\\_f\\_sign.pdf](http://www.ecb.int/ecb/legal/pdf/en_con_2011_103_f_sign.pdf) (“In addition, the ECB welcomes that the draft law and the draft royal decrees accommodate several recommendations in previous ECB opinions on resolutions funds.”).



softer powers in the context of its participation in transnational work on financial stability and consultation on EU and Member State initiatives. By 2012, the ECB was a much more visible entity than it was before the crises. In the summer of 2012, Herman van Rompuy proposed that the ECB should become a banking regulator.<sup>136</sup> The IMF called for the EU to establish banking and fiscal unions at that time.<sup>137</sup>

#### IV. IMAGINING THE EU'S FUTURE

During the two recent crises, the management of financial regulation, financial stability, and economic governance has evolved: there are new, more detailed rules, and EU agencies, such as the ECB, ESMA, and the EBA, have new roles and new powers. Reactions to the crises have involved a combination of technical and political responses, and new examples of the incremental nature of EU policy making. The terms on which the Member States collaborate are again subject to negotiation and renegotiation (a new illustration of the dialectic between nation-states and the community referred to at the beginning of this Article). Because the negotiations are ongoing, as of the fall of 2012, it is unclear what EU financial regulation and economic governance will look like in the future. There are more questions than answers. This section of the Article focuses on some of these questions.

A significant part of the problems the EU faces relates to the linkages between financial institutions and the sovereign states in whose debt they have invested, and where they are based. The financial markets have lost confidence in banks and in many eurozone sovereign debtors. The crises illustrate the enormous power the financial markets can exert over members of a monetary union.<sup>138</sup> The EU has sought to control the exercise of this power by limiting the ability of financial market participants to bet against sovereign debt.<sup>139</sup> The EU also sought to increase the confidence of the financial markets in the eurozone by signing both the Fiscal Stability Treaty

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<sup>136</sup> Towards a Genuine Economic and Monetary Union, *supra* note 13.

<sup>137</sup> IMF, IMF COUNTRY REPORT NO. 12/181, EURO AREA POLICIES: 2012 ARTICLE IV CONSULTATION 10 (2012), available at <http://www.imf.org/external/pubs/ft/scr/2012/cr12181.pdf> ("Only a convincing and concerted move toward a more complete EMU could arrest the decline in confidence engulfing the region. A credible roadmap toward a full banking union and fiscal integration will make the short-term crisis measures more effective. Structural reforms throughout the euro area will also be necessary to revive growth in the long run, while macroeconomic policies can smooth the needed adjustment in the short run.").

<sup>138</sup> See, e.g., Paul De Grauwe, *A Fragile Eurozone in Search of a Better Governance*, 43 *ECON. & SOC. REV.* 1, 4 (2012) ("[I]n a monetary union, financial markets acquire tremendous power and can force any member country on its knees."). De Grauwe notes that, in 2011, U.K. government debt was a higher proportion of GDP than Spanish government debt, yet the financial markets assessed Spain's risk of default as higher than that of the United Kingdom. *Id.* at 2.

<sup>139</sup> See, e.g., Council Regulation 236/2012, *supra* note 84, at 1, ¶ 22 ("Since entering into a sovereign credit default swap without underlying exposure to the risk of a decline in the value of the sovereign debt could have an adverse impact on the stability of sovereign debt markets, natural or legal persons should be prohibited from entering into such uncovered credit default swap positions.").

and the ESM Treaty, but progress on ratification was slow. The German Constitutional Court was invited to consider whether the ESM Treaty is compatible with the German Constitution,<sup>140</sup> and declined to issue injunctions preventing the German President from signing the treaty.<sup>141</sup> An Irish referendum approved the Fiscal Stability Treaty,<sup>142</sup> but the Irish government decided not to hold a referendum on the ESM Treaty.<sup>143</sup> Thomas Pringle, an Irish citizen and a member of Dáil Éireann, one of the Houses of the Oireachtas, the Irish national parliament, challenged the ESM Treaty in the Irish Courts. The Irish Supreme Court opined that the Treaty did not “involve a transfer of sovereignty so as to make it incompatible with the Constitution” and made a preliminary reference to the Court of Justice on questions relating to the validity of the ESM Treaty under EU law.<sup>144</sup> The Court of Justice agreed to hear the case promptly and held a hearing in October 2012,<sup>145</sup> but the delay does not help to reassure the financial markets.<sup>146</sup> Litigation about whether acts of the EU and its Member States are consistent with EU law is frequent and consistent with protecting the democratic legitimacy of the EU. The need to seek citizen approval for changes to the EU’s rules and to wait for the Court of Justice to decide on the legality of rule changes makes it harder for the EU to respond to the crisis. At the same time, the EU’s legitimacy depends on developing, rather than constraining, democracy and adhering to the rule of law. Even with the new treaties in place, it is not clear whether the EU will be able to overcome the political difficulties which impeded effective economic governance in the past. The treaties do, however, signal a renewed commitment to improving economic governance.

The EU’s next steps involve negotiation of the details of a European Banking Union involving banking supervision by the ECB. Moves to ensure that regulators consider issues of financial stability have meant that central

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<sup>140</sup> Quentin Peel & Jamie Smyth, *German Lawsuit Challenges Rescue Fund*, FIN. TIMES, Aug. 13, 2012, <http://www.ft.com/intl/cms/s/0/fda2f444-e562-11e1-9a2f-00144feab49a.html>.

<sup>141</sup> Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] Sept. 12, 2012, BVERFGE 1390, 2012 (Ger.).

<sup>142</sup> Eamon Gilmore, *Ireland’s Fiscal Stability Referendum: A Yes for Recovery*, GUARDIAN, June 1, 2012, <http://www.guardian.co.uk/commentisfree/2012/jun/01/ireland-referendum-yes-recovery>.

<sup>143</sup> *European Stability Mechanism (ESM) Treaty: Fiscal Compact’s Equally Obnoxious Brother*, PEOPLE’S MOVEMENT, <http://www.irishreferendum.org/p/european-stability-mechanism-esm-treaty.html> (last visited Feb. 17, 2013).

<sup>144</sup> Pringle v. Gov’t of Ir., [2012] I.E.S.C. 47 (Ir.).

<sup>145</sup> Press Release, Thomas Pringle TD, Pringle Welcomes CJEU Court Date (Aug. 15, 2012), available at <http://www.thomaspringle.ie/?p=1058>.

<sup>146</sup> Interview with Christian Noyer, Governor of the Bank of Fr. and Chairman of the Bd. of Dirs. of the Bank for Int’l Settlements (Aug. 9, 2012), transcript available at <http://www.bis.org/review/r120820a.pdf> (“Markets would like to have everything settled within five minutes. But there are 17 democracies in the euro area and 27 democracies in the European Union. The time perspective of the markets is not that of democracies. Like Jean Monnet, I believe that Europe will be forged in crises.”).

banks have developed new powers with respect to financial regulation. Giving more responsibilities for financial regulation to the ECB makes sense from the perspective of financial stability, and it would also address the connections between financial firms and sovereign debtors, which have proved to be so problematic. But developing a system in which the ECB is responsible for bank regulation, and that is also consistent with the single market in financial services, will be complicated.<sup>147</sup> Harmonized bank regulation in the EU was designed to open up domestic markets within the Member States to banks based in other Member States. Bank regulation was imagined as an enterprise distinct from monetary policy in the eurozone area. But the opening up of domestic financial markets also increased the risk of contagion within the EU and particularly within the eurozone.

Herman van Rompuy's proposal for the ECB to take on responsibility for bank regulation (prepared in close cooperation with the Presidents of the Commission, the Eurogroup, and the ECB) stated that:

The current architecture should evolve as soon as possible towards a single European banking supervision system with a European and a national level. The European level would have ultimate responsibility. Such a system would ensure that the supervision of banks in all EU Member States is equally effective in reducing the probability of bank failures and preventing the need for intervention by joint deposit guarantees or resolution funds. To this end, the European level would be given supervisory authority and pre-emptive intervention powers applicable to all banks. Its direct involvement would vary depending on the size and nature of banks. The possibilities foreseen under Article 127(6) TFEU regarding the conferral upon the European Central Bank of powers of supervision over banks in the euro area would be fully explored.<sup>148</sup>

In addition, he proposed a "European deposit insurance scheme" and a "European resolution scheme."<sup>149</sup> The report characterizes its proposals as "a vision for the future of EMU governance" having to do with deeper economic and monetary union.<sup>150</sup> But establishing a eurozone deposit insurance scheme and European resolution scheme that would not apply to banks outside the eurozone would draw new distinctions between eurozone and EU

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<sup>147</sup> Cf. Towards a Genuine Economic and Monetary Union, *supra* note 13, at 4 ("[A]n integrated financial framework should cover all EU Member States, whilst allowing for specific differentiations between euro and non-euro area Member States on certain parts of the new framework that are preponderantly linked to the functioning of the monetary union and the stability of the euro area rather than to the single market.").

<sup>148</sup> *Id.* at 4.

<sup>149</sup> See *id.* at 4, 5.

<sup>150</sup> *Id.* at 3.

banks. In this sense, it would seem impossible to develop a system of eurozone bank regulation that did not interfere with the single market. An IMF paper, endorsing the idea of a European Banking Union, suggests that other Member States should be allowed to opt into the new system.<sup>151</sup> U.S. banking regulation tends to focus on the ability of banks to exercise some choice about the rules that apply to them. The U.S. system centralizes responsibility for deposit insurance and bank resolution in the Federal Deposit Insurance Corporation. However, banks can choose to be chartered either by state banking regulators or as national banks.<sup>152</sup> The rules that apply to banks have implications for their ability to compete with other banks and financial institutions. Differences between the rules and supervisory arrangements applying to eurozone and non-eurozone banks in the EU will likewise have implications for competition between banks and financial centers. The U.K. House of Lords European Union Committee established an inquiry into the proposed changes and issued a call for evidence, noting that:

Although the Government have made clear that the UK will not take part in the fundamental elements of a banking union, the implications of these developments for the UK cannot be ignored. The Government argue that the UK's non-participation should not and need not adversely affect London's position as the leading financial centre in Europe, nor undermine the single market. The strength of this argument may soon be tested.<sup>153</sup>

Developing the ECB's role as a bank supervisor in addition to its other functions would require an increase in the ECB's financial and personnel resources. The ECB would need to employ bank supervisors even if some of the work of bank supervision were to continue to be done by national bank regulators. The details of the arrangements for a banking union involve demarcating the responsibilities of the ECB and national regulators and of the ECB and EBA. Drawing these lines is likely to be complex.

Although the document proposing a banking union refers to banking supervision, Article 127(6) TFEU "relates to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings,"<sup>154</sup> implying that it may be possible to address

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<sup>151</sup> IMF, IMF COUNTRY REPORT NO. 12/182, EURO AREA POLICIES: 2012 ARTICLE IV CONSULTATION—SELECTED ISSUES PAPER 15 (2012) ("The framework of the Banking Union should allow other countries to opt-in.").

<sup>152</sup> See, e.g., OFFICE OF THE COMPTROLLER OF THE CURRENCY, DEP'T OF THE TREASURY, NATIONAL BANKS AND THE DUAL BANKING SYSTEM (2003) (U.S.).

<sup>153</sup> EUR. UNION COMM., HOUSE OF LORDS, INQUIRY INTO REFORM OF THE EU BANKING SECTOR: CALL FOR EVIDENCE (2012) [hereinafter HOUSE OF LORDS, BANKING SECTOR INQUIRY], available at <http://www.parliament.uk/documents/lords-committees/eu-sub-com-a/BankingReform/CFEBankingReform.pdf>.

<sup>154</sup> Article 127(6) TFEU provides:

issues with respect to shadow banking.<sup>155</sup> Including some supervision with respect to shadow banks in the new EU rules seems appropriate from the perspective of addressing systemic risk, although it would create larger issues relating to competition than a narrower banking union and would likely make it more difficult to achieve agreement. Since measures adopted under Article 127(6) TFEU require unanimity in the Council, this would give negotiating power to countries outside the eurozone, such as the U.K., which currently hosts significant financial activity, as the above quote from the House of Lords' call for evidence notes.<sup>156</sup>

The eurozone particularly seems to need a banking union more than the broader EU. It is the combination of crises facing the eurozone that prompted the proposal to intensify harmonization of banking regulation in the first place. However, the logic of the single market demands that single market rules should be harmonized for the whole market, not just for one segment of that market.

The European Council responded to the banking union proposal with a request for more concrete proposals to be developed in consultation with Member States and the European Parliament.<sup>157</sup> In particular, the European Council noted that amendments to the EU Treaties might be necessary.<sup>158</sup> The original proposal had envisaged "wide consultation and participation" in realizing its vision, and consultation and participation not just of bankers but also of citizens.<sup>159</sup> In September 2012, the Commission published a more detailed outline of how the EU might achieve a Banking Union,<sup>160</sup> described as a "Roadmap," together with a proposed regulation amending the EBA

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The Council, acting by means of regulations in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament and the European Central Bank, confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

TFEU, *supra* note 104, art. 127(6).

<sup>155</sup> Cf. ECB, COMMISSION'S GREEN PAPER ON SHADOW BANKING: THE EUROSISTEM'S REPLY 1 (July 5, 2012), available at <http://www.ecb.europa.eu/pub/pdf/other/commissionsgreenpaperonshadowbankingeurosistemreplyen.pdf> ("The ECB/Eurosistem is very interested on (sic) shadow banking for its importance for the financial stability of the euro-area.").

<sup>156</sup> HOUSE OF LORDS, BANKING SECTOR INQUIRY, *supra* note 153.

<sup>157</sup> Council Conclusions 76/12, *supra* note 13, at 3.

<sup>158</sup> *Id.* ("They will examine what can be done within the current Treaties and which measures would require Treaty change.").

<sup>159</sup> Towards a Genuine Economic and Monetary Union, *supra* note 13, at 3 ("Overall, closer EMU integration will require a stronger democratic basis and broad support from citizens. For this reason, it is essential that already the process towards realising this vision is based on wide consultation and participation. Integration and legitimacy have to advance in parallel.").

<sup>160</sup> *A Roadmap Towards a Banking Union*, COM (2012) 510 final (Sept. 12, 2012) [hereinafter *Roadmap*].

regulation to confer powers on the ECB,<sup>161</sup> and a proposed regulation to empower the ECB to exercise powers with respect to banking regulation.<sup>162</sup> In the Roadmap, the Commission characterized the single market and the European Banking Union as “mutually reinforcing processes.”<sup>163</sup> For the Commission, this means that all EU Member States will be subject to the same rules with respect to deposit insurance and recovery and resolution.<sup>164</sup> The EU will have a common supervisory culture,<sup>165</sup> but Member States outside the eurozone could choose to opt in to closer cooperation with the ECB.<sup>166</sup> National banking regulators in the eurozone are to remain responsible for consumer protection, money laundering, and supervising branches or activities of banks from non-European Economic Area countries.<sup>167</sup> The Roadmap states that the Commission eventually plans to make proposals for a resolution regime for the banking union as “a natural complement to the establishment of a single supervisory mechanism.”<sup>168</sup> The proposed regulation to amend the existing EBA regulation contains detailed proposals to adjust voting within the EBA to give sufficient, but not excessive, voice to the ECB as a competent authority.<sup>169</sup>

Although the Commission has fleshed out some of the details of the European Banking Union plan, the Roadmap recognizes that the Member States have not yet reached agreement on significant components of the single rulebook—in particular, the proposals for deposit insurance and recovery and resolution—and acknowledges that there are still other missing elements of the plan, such as the resolution regime for the banking union. Under the new proposals, the ECB is responsible for authorizing banks and

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<sup>161</sup> *Proposal for a Regulation of the European Parliament and of the Council Amending Regulation (EU) No 1093/2010 Establishing a European Supervisory Authority (European Banking Authority) as Regards its Interaction with Council Regulation (EU) No.../... Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions*, COM (2012) 512 final (Sept. 12, 2012).

<sup>162</sup> *Proposal for a Council Regulation Conferring Specific Tasks on the European Central Bank Concerning Policies Relating to the Prudential Supervision of Credit Institutions*, COM (2012) 511 final (Sept. 12, 2012).

<sup>163</sup> *Roadmap*, *supra* note 160, at 4.

<sup>164</sup> *Id.* at 5.

<sup>165</sup> *Id.*

<sup>166</sup> *Id.* at 7.

<sup>167</sup> *Id.*

<sup>168</sup> *Roadmap*, *supra* note 160, at 9.

<sup>169</sup> COM (2012) 512 final, *supra* note 161, at 3–5 (noting that the ECB is to be a competent authority, the Commission went on to observe that, “[i]f voting rights remain unchanged, it cannot be ensured that decisions taken by simple majority will always represent the interests of the Union as a whole. Voting arrangements need therefore to be adjusted in some specific cases of simple majority to ensure that the integrity of the internal market remains preserved while avoiding at the same time the risk of paralysing the EBA decision making. . . . Article 45 of the EBA Regulation is therefore amended to ensure that the Management Board includes at least two Member States which are not participating in the SSM”).

withdrawing authorizations. But agreement on a resolution regime is critical for the successful implementation of a European Banking Union. In addition, the ECB does not have expertise in banking supervision.<sup>170</sup> The Commission's proposals suggest that the ECB should benefit from the expertise of national regulators.<sup>171</sup> The elements of the European Banking Union are complex, and the process of achieving it is clearly long and uncertain. However, the European Banking Union is a new demonstration that whereas the EU's decision making structures do not always allow for quick responses to situations of crisis, crises may prompt reforms which might not otherwise be considered.

## V. CONCLUSION

In conclusion, the EU is moving further towards a system of financial regulation with EU-level agencies exercising supervision over an increasing range of financial activity. ESMA supervises credit rating agencies, and the ECB may supervise banks in the eurozone and, presumably, their subsidiaries outside the eurozone.<sup>172</sup> These developments are interesting not just to observers of the EU but also to observers of financial regulation more generally, and especially to those who are concerned about the ability of regulators embedded in national jurisdictions to regulate financial activity which easily crosses geographic boundaries. For academic commentators who argue for the establishment of an international regulator of financial activity,<sup>173</sup> the EU's actions and travails provide a useful case study. But it is a case study with its own particular features which create some ambiguities. In part because financial regulation is part of a larger picture of integration in the EU than it is at the international level, the EU has been able to achieve more harmonization, and more binding harmonization, than the international community supports.

At the same time, the fact that the EU is a political as well as an economic or regulatory organization means that achieving agreement on further integration takes time and requires some action to achieve buy-in from citizens. The EU's procedures for informing citizens and encouraging them to participate in decision making may not go as far as some would

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<sup>170</sup> COM (2012) 511 final, *supra* note 162, at 11 ("The ECB should therefore have the task to authorise credit institutions and should be responsible for the withdrawal of authorisations.").

<sup>171</sup> *Id.* at 14 ("National supervisors have important and long-established expertise in the supervision of credit institutions within their territory and their economic, organisational and cultural specificities. They have established a large body of dedicated and highly qualified staff for these purposes. Therefore, in order to ensure high quality European supervision national supervisors should assist the ECB in the preparation and implementation of any acts relating to the exercise of the ECB supervisory tasks.").

<sup>172</sup> See, e.g., Andrew Duff, *What the EU Agreed Last Week, What it Did Not and What Happens Next*, EUOBSERVER.COM (July 3, 2012), <http://euobserver.com/843/116855> (noting that "[t]he Czechs and Poles have initial worries about losing all control over their banks (which are subsidiaries of eurozone banks)").

<sup>173</sup> See, e.g., Pan, *supra* note 5.

like,<sup>174</sup> but the EU's procedures for consulting citizens are much more advanced than those of standard-setters such as the Basel Committee.<sup>175</sup> Within the EU, there are many groups that are prepared to challenge the idea that matters of financial regulation are purely technical issues that experts must decide.<sup>176</sup> Engaging citizens in the details of financial regulation is a more complex matter.<sup>177</sup> But whereas EU scholars sometimes argue that output legitimacy (good policy) is as good as input legitimacy (good processes for developing policy),<sup>178</sup> the costs of the crises show that financial regulation has distributive implications. The costs that failures of financial firms have imposed on European citizens have made it clear that financial regulation in the EU is a political, rather than a technical, issue.<sup>179</sup> But the costs of failing to resolve the EU's crises could be even greater.

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<sup>174</sup> For an assessment of the EU's transparency policies in the context of financial regulation, see Caroline Bradley, *Transparency and Financial Regulation in the European Union: Crisis and Complexity*, 35 *FORDHAM INT'L L.J.* 1171 (2012).

<sup>175</sup> Cf. Caroline Bradley, *Consultation and Legitimacy in Transnational Standard-Setting*, 20 *MINN. J. INT'L L.* 480 (2011).

<sup>176</sup> For example, the European Federation of Financial Services Users has a number of members from different EU Member States. See *History*, EUROFINUSE, <http://www.eurofinuse.org/index.php?id=74> (last visited Mar. 16, 2013).

<sup>177</sup> On the difficulties of engaging citizens in discussions of financial regulation, see Caroline Bradley, *Transparency Is the New Opacity: Constructing Financial Regulation After the Crisis*, 1 *BUS. L. BRIEF (AM. U.)* 7 (2011–12).

<sup>178</sup> See, e.g., Deirdre Curtin & Albert Jacob Meijer, *Does Transparency Strengthen Legitimacy?*, 11 *INFO. POLITY* 109, 112 (2006) ("On the whole the legitimacy of the EU and its decisions has tended to be focussed [sic] on the output side of the equation . . . rather than on the input side.").

<sup>179</sup> Cf. *FIN. SERV. CONSUMER PANEL, GETTING CONSUMERS A FAIR DEAL FROM REGULATORY REFORM: BRIEFING ON THE FINANCIAL SERVICES BILL (2012)* (U.K.), available at <http://www.fsc-p.org.uk/publications/pdf/fsb-briefing.pdf> ("The Financial Services Consumer Panel represents the interests of consumers by advising the Financial Services Authority (FSA) on policy. The Consumer Panel believes that the recent economic crisis and the financial scandals of the last decade have demonstrated beyond all doubt that consumers need to have a strong voice in the regulatory system.").