Reforms of EU Banking and Securities Regulation after the Financial Crisis

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Both in the U.S. and Europe, the global financial crisis has led to a plethora of substantive and institutional reforms, mainly with respect to banking and financial stability, but also as regards securities regulation and respective market supervision. Many of these reforms trace back to initial political impetus given at the international level by the Group of 20, the Financial Stability Forum and the Basel Committee on Banking Supervision. Others are the result of particular national (or regional) market conditions. Given their sheer number and diversity, keeping track of all relevant developments presents an increasingly formidable challenge. Following a brief description of some basic legal principles of the European Union, this article provides an overview of the numerous crisis-driven reforms of EU banking and securities regulation until October 2010, including applicable institutional frameworks and law-making procedures. Where appropriate, particular attention is paid to aspects of extra-territorial relevance, i.e., such regulatory issues that may also concern market participants domiciled in countries outside the European Union.

Tant aux États-Unis qu'en Europe, la crise financière mondiale a provoqué une kyrielle de réformes de fond, visant principalement à assurer la stabilité bancaire et financière, mais relatives aussi à la réglementation des valeurs mobilières et à la surveillance des marchés. Bon nombre de ces réformes s'inscrivent dans la foulée d'une première impulsion politique donnée à l'échelle internationale par le Groupe des Vingt, le Conseil de stabilité financière et le Comité de Bâle sur le contrôle bancaire. D'autres s'expliquent par les caractéristiques particulières de certains marchés nationaux (ou régionaux). Compte tenu du grand nombre de ces réformes et de leur grande diversité, il devient de plus en plus difficile de rester au fait de tous les développements pertinents en ce domaine. Après une courte description de certains principes juridiques fondamentaux de l'Union européenne, l'article passe en revue celles des réformes issues de la crise, jusqu'en octobre 2010, qui visent la règlementation des valeurs mobilières et des banques, notamment en ce qui a trait aux cadres institutionnels applicables et aux processus législatifs. L'article traite également de la portée extraterritoriale de certaines règles,

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dans la mesure où elles visent des acteurs du marché domiciliés à l'extérieur de l'Union européenne.

1. INTRODUCTION

On July 16, 2010, the U.S. Congress adopted the *Dodd-Frank Wall Street Reform and Consumer Protection Act*[1] — an Act, according to its preamble, to "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes". The post-crises activities of the European Union (EU) regarding banking and securities regulation and supervision are just as overwhelming. Specific features of the EU legislative process make it particularly difficult to see the "big picture". First, in contrast to the U.S., the numerous reform proposals have not been folded into one bill, but are discussed separately and, as a corollary, will enter into force at different points in time. Second, because of the implementation of the *Lamfalussy* process, the EU's legislative procedure in the field of securities, banking, and insurance regulation has become a most intricate one, not the least because of the large number of bodies involved: the Council, Commission, Parliament and its Committees, the European bodies of national supervisory authorities (CESR, CEBS, CEIOPS), the European Central Bank, and others.

Admittedly, the EU is lagging behind somewhat in the final adoption of the numerous legislative reform proposals currently under discussion. In particular, while the European Parliament has favored sweeping reforms, the (European) Council representing Member States' governments has often adopted a more cautious approach. However, in July 2010, both the Council and Parliament signalled their willingness to arrive at compromise solutions in autumn, based on proposals already in existence.

Against this backdrop, this article reports on some important elements of the emerging "big picture". Given the unique Treaty-based institutional organization of the EU and the fact that the EU is implementing fundamental changes in its supervisory architecture, as well, this report proceeds as follows: part 2 provides a brief overview of the institutional framework of the European Union, while part 3 outlines the current framework of banking and securities regulation. Parts 4 to 6 then describe post-crisis developments. Part 4 outlines the attempts at arriving at a stronger, more coordinated supervisory architecture, part 5 describes changes in banking regulation that have been adopted or are imminent, while part 6 reports on developments regarding securities regulation and related fields. Finally, part 7 offers some concluding remarks.

[1] H.R. 4173.

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2. OVERVIEW OF THE INSTITUTIONAL FRAMEWORK OF THE EUROPEAN UNION

(a) Treaty-Based Foundation

Until 1992, European legal integration proceeded within the framework of the 1957 *Treaty of Rome*, establishing the European Economic Community (EEC) to promote economic cooperation alongside a European Atomic Energy Community (Euratom) and the 1951 European Coal and Steel Community (ECSC).[2] A common market was to be created in several transitional stages, including, *inter alia*, coordination on a variety of Community policies (*e.g.*, agriculture, monetary and employment affairs, competition law), the removal of internal tariff barriers and the creation of a common external customs tariff.

In 1992, the *Maastricht Treaty on European Union* (TEU) introduced new forms of cooperation between the Member States, *e.g.*, on defense policy and the justice and home affairs sector, and established the European Union that was to rest on both a political and an economic pillar. As a corollary, the EEC *Treaty of Rome* was renamed *Treaty Establishing the European Community* (TEC). Following a series of further reforms,[3] the TEC has recently been recast as the *Treaty on the Functioning of the European Union* (TFEU) laying down in great detail the procedures of EU policy and lawmaking. In general, the treaties establishing the European Union and its institutions are referred to as "primary" EU law which has direct legal force in every Member State, overriding any inconsistent national law.

(b) Main Bodies and Functions

The principal institutions are the (European) Council, the European Parliament, the European Commission and the European Court of Justice (ECJ).

The supreme legislative and budgetary bodies of the European Union are the (European) Council — also referred to as the Council of Ministers — and the European Parliament. Both share in the legislative powers attributed to the EU by the TFEU, *i.e.*, for legislative acts to be passed the consent of both the Council and Parliament is required.[4] The Council consists of representatives of the Member States' governments (ministers) whose membership is dependent on the subject matter in question. If general matters of political direction and priorities are at

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2 For a detailed analysis of the history and development of European integration see Paul Craig & Gráinne de Búrca, *EU Law — Text, Cases and Materials* 3rd ed. (Oxford: Oxford University Press, 2003) at 3 et seq.

3 See overview online: <http://europa.eu/abc/treaties/index_en.htm>. The latest reform was brought about by the 2007 *Reform Treaty of Lisbon* which entered into force in December 2009.

4 Details of the power-sharing between the two institutions are rather complex; see for more details, *e.g.*, P. J. G. Kapteyn & P. VerLoren van Themaat, *Introduction to the Law of the European Communities* 3rd ed. (London/The Hague/Boston: Kluwer Law International, 1998) at 209, 217 et seq. and online: <http://www.europarl.europa.eu/>. With respect to financial and banking regulation in particular, the Commission may enact pieces of legislation based on *delegated* powers of legislation under Art. 290 TFEU. See in more detail *infra*, part 3(a).

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stake, the Council consists of the Heads of State or Government and the President of the Commission, in which case it is called the "European Council" (see Article 15 TEU).

The Commission's functions are threefold. Perhaps most importantly, it is tasked with promoting EU integration and harmonization by virtue of having an (almost[5]) exclusive right to initiate new legislative measures. It also oversees and enforces the fulfillment of the obligations of Member States and individuals (barriers to competition, merger control, state aid control) arising out of the treaties and exercises executive competences by, *e.g.*, implementing policy decisions under powers delegated by the Council (see Article 17 TEU). In the light of these functions, the Commission has been described as "the guardian of the treaties" and "the driving force behind European Integration".[6]

Finally, the ECJ is the supreme judicial authority on all matters of EU law. It has to determine violations of the law and impose appropriate sanctions in matters brought before it, either directly by the parties affected or on application from national courts in so-called "preliminary rulings".[7]

(c) Instruments of Law-Making

The TFEU provides for three instruments of law-making by the EU: *Directives*, *Regulations* and *Decisions*. These are usually referred to as "secondary" EU law and, as is the case with primary EU law, take precedence over inconsistent national law.[8] In many instances the Commission, Council and Parliament are free to choose among the instruments since there is no formal hierarchy between them. Furthermore, the institutions may issue so-called *Recommendations* and *Opinions* as supplementary means of policy making.

According to Article 288 of the TFEU (formerly Article 249 TEC), a *Directive* is a legislative instrument which is legally binding. However, in general, *Directives* will have a binding effect only on Member States, but lack direct applicability within the Member States' national legal systems. Instead they have to be transposed into national law by the Member States themselves, usually within a stipulated period of time, allowing the states a certain amount of discretion as to the form and methods of implementation. Given specific circumstances, *Directives* may be directly effective and empower individuals to rely on them, at least in actions against the State.[9] *Directives* are particularly useful when the aim is to harmonize the laws within a certain field or to introduce complex legislative change.[10]

By contrast, *Regulations* are the equivalent at the EU level to a Member

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5 For some rare exceptions see Arts. 17(2) TEU, 289 TFEU.

6 For a detailed analysis of the Commission's traditional functions and powers under the TEC see P. J. G. Kapteyn & P. VerLoren van Themaat, *supra*, n. 4 at 195 *et seq*.

7 P. J. G. Kapteyn & P. VerLoren van Themaat, *supra*, n. 4 at 249 *et seq*.; see also online: <http://curia.europa.eu/>.

8 P. J. G. Kapteyn & P. VerLoren van Themaat, *supra*, n. 4 at 551; Paul Craig & Gráinne de Búrca, *supra*, n. 2 at 275 *et seq*.

9 See Paul Craig & Gráinne de Búrca, *supra*, n. 2 at 93 *et seq*.; P. J. G. Kapteyn & P. VerLoren van Themaat, *supra*, n. 4 at 535–537.

10 Paul Craig & Gráinne de Búrca, *supra*, n. 2 at 115.

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State's statutes, *i.e.*, they do not require implementation. Put differently, they are legally binding not only on Member States, but also on individuals and entities independently of any national law. *Decisions*, in turn, are binding only on the particular State, individual or entity to which they are addressed. *Recommendations* and *Opinions* have no binding force at all, but may be of persuasive authority.

In addition, EU institutions may avail themselves of a range of instruments which, although not explicitly stipulated by the TFEU, have emerged in day-to-day practice. These include declarations, deliberations, resolutions, communications, codes of conduct, inter-institutional agreements, conclusions and, perhaps most importantly, *White* and *Green Papers*. *White Papers* are usually published by the Commission as proposals for legislative action in specific areas, whereas the purpose of *Green Papers* is to encourage reflection and public debate, and may give rise to future legislative developments — which are usually outlined in subsequent *White Papers*.[11]

3. CURRENT FRAMEWORK OF BANKING AND SECURITIES REGULATION

(a) Institutional Framework and Legislative Procedures (*Lamfalussy* Process)

Until ten years ago, given the legal framework for European integration established by the treaties, legal harmonization in general as well as harmonization of banking and securities regulation in particular progressed rather slowly, largely because of the rather bureaucratic, ineffective structures of traditional legislative procedures and institutions which were occasionally unable to keep pace with the increasing complexity and challenges of more and more globalized capital markets.

As a consequence, in 1999, the Commission initiated the five-year Financial Services Action Plan (FSAP),[12] comprising forty-two proposals concerning the elimination of market fragmentation by creating an integrated European market in financial services and securities trading to be implemented by 2004. One of the FSAP's core objectives was to provide for a more efficient and accelerated legislative procedure in this sector, not the least to achieve and uphold a level playing field with respect to U.S. standards. For this purpose, the Commission on the basis of an antecedent EU Council decision (the so-called "Comitology Decision"[13]) set up an expert advisory committee of "wise men" chaired by the former general director of the Bank for International Settlements (BIS), *Baron Alexandre Lamfalussy*, in July 2000.[14]

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11 For a very recent example see *infra*, n. 155 and accompanying text.

12 Communication COM (1999) 232 final of 11/5/1999, online: <http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf>.

13 *Decision* 1999/468/EC of 28/6/1999, as amended by Council *Decision* 2006/512/EC of 17/7/2006.

14 See also Mathias M. Siems, "The Foundations of Securities Law" (2009) European Business Law Review 141 at 165 *et seq.*; Eddy Wymeersch, "The Future of *Financial Regulation* and Supervision in Europe" (2005) Common Market Law Review 987 at

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The committee's final report[15] recommended that new legislation in the securities sector was to be passed and implemented following a swift and transparent four-level procedure (the "Lamfalussy process") with the participation of two new expert consultative bodies, namely the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR).[16] The ESC was composed of high level representatives from the Member States and chaired by a delegate of the Commission, while the CESR was made up of high-ranking members of each Member State's financial supervisory authority.[17]

Initially, the introduction of the Lamfalussy process was welcomed as a substantial improvement in the effectiveness of EU law-making.[18] Indeed, the average time span for adopting a *Directive* shrank to about twenty months, whereas previously, it could take up to nine years.[19] Moreover, the involvement of expert groups is said to improve the quality of supervisory standards, facilitate greater flexibility, transparency and harmonization in an inter-institutional legislative process,[20] and, at the same time, reduce transaction costs for market participants. On the other hand, critics point out that the EU is now very much involved in the details of financial services law, which might thus become "too detailed, technical, abstract

989 *et seq*.; A. W. H. Docters van Leeuwen, "The Growth of a Virtual Network: Past, Present and Future of CESR" (2005) European Company Law 9.

15 Available online: <http://ec.europa.eu/internal_market/securities/lamfalussy/index_en.htm>.

16 For a helpful graphic representation of the four-level regulatory approach under the Lamfalussy process see the Commission Staff Working Document (impact assessment) SEC (2009) 576 of 30/4/2009, at 121, available online: <http://ec.europa.eu/internal_market/investment/alternative_investments_en.htm>. For a detailed legal analysis of the Lamfalussy process and its impacts see Thomas M. J. Möllers, "European Legal Theory and Legislation in Capital Market Law, Complete harmonization, blanket clauses and soft law as means for creating standards in the context of the Lamfalussy Process" (2009) Journal of Interdisciplinary Economics, Volume 2.

17 CESR was appointed by the European Commission on the basis of *Decision* 2001/527/EC of 6/6/2001 (as amended by *Decision* 2004/7/EC of 5/11/2003); for further details see A. W. H. Docters van Leeuwen, "The Growth of a Virtual Network: Past, Present and Future of CESR", *supra*, n. 14.

18 See *e.g.*, Niamh Moloney, "Time to Take Stock on the Markets: The Financial Services Action Plan Concludes as the Company Action Plan Rolls Out" (2004) 53 International & Comparative Law Quarterly 999 at 1007; see also Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", in: Stefan Grundmann, Brigitte Haar, Hanno Merkt *et al.*, (ed.), *Festschrift für Klaus J. Hopt* (Berlin/New York: de Gruyter, 2010) 2265 at 2281.

19 Commission Staff Working Document "The Application of the Lamfalussy Process to EU Securities Markets Legislation — A preliminary assessment by the Commission services" of 15/11/2004 at 1, 6; online: <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/sec-2004-1459_en.pdf>.

20 See Inter-Institutional Monitoring Group (IIMG), "Third Report monitoring the Lamfalussy Process" of 17/11/2004, at 6, 17 *et seq*.; online: <http://ec.europa.eu/internal_market/securities/monitoring/index_en.htm>.

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and rigid".[21] Others take issue with the impact on the European Parliament which is said to play a mere supporting role at levels two and three of the procedure.[22]

Notwithstanding these criticisms, beginning in November 2003, application of the *Lamfalussy* procedure has been extended to the banking and insurance sector, with the European Banking Committee (EBC)[23] and the European Insurance and Occupational Pensions Committee (EIOPC) having been appointed as equivalent bodies to the ESC, and the Committee of European Banking Supervisors (CEBS)[24] and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)[25] as counterparts to the CESR, including the conferral of respective functions and powers.

(b) Banking Regulation

Harmonization of EU banking regulation started in 1977 with the Commission introducing the first *Coordination Directive* on the coordination of the laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions.[26] Subsequent steps included the first *Banking Consolidation Directive*,[27] designed primarily to eliminate inappropriate intra-group creation and the use of own funds as buffers against credit risks in two or more legal entities (so-called "double" or "multiple gearing"), and a *Directive* on the standards of annual and consolidated accounting applicable to credit institutions.[28] Further impulses for harmonization were created by the Commission *White Paper* to the Eu-

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21 Guido Ferrarini, "Contract Standards and the Markets in Financial Instruments Directive (MiFID)" (2004) European Review of Contract Law 19; Niamh Moloney, "Innovation and Risk in EC Financial Market Resolution: New Instruments of Financial Market Intervention and the Committee of European Securities Regulators" (2007) 32 European Law Review 627; see also Mathias M. Siems, "The Foundations of Securities Law", *supra*, n. 14 at 167.

22 See Mathias M. Siems, "The Foundations of Securities Law", *supra*, n. 14 at 167, 168.

23 Established on the basis of Commission decision 2004/10/EC of 5/11/2003; see online: <http://ec.europa.eu/internal_market/bank/ebc/index_en.htm>.

24 See Commission decision 2004/5/EC of 5/11/2003. Recent CEBS activities of major interest include the conduct of EU-wide stress testing exercises, designed to assess the resilience of EU credit institutions to potential adverse economic developments and the ability of banks to absorb possible shocks on credit and market risks; see online: <http://www.eba.europa.eu/EUWideStressTesting.aspx>.

25 For details see online: <http://ec.europa.eu/internal_market/insurance/committee_en.htm>.

26 *Directive* 77/780/EEC of 12/12/1977; *inter alia*, the requirement and preconditions of obtaining an authorization before commencing banking activities were codified in this *Directive*.

27 *Directive* 83/350/EEC of 13/6/1983, now replaced by *Directive* 92/30/EEC of 6/4/1992.

28 *Directive* 86/635/EEC of 8/12/1986, amended by *Directives* 2001/65/EC of 27/9/2001, 2003/51/EC of 18/6/2003, 2006/43/EC of 17/5/2006 and 2006/46/EC of 14/6/2006.

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ropean Council in 1985,[29] leading, *inter alia*, to a second *Coordination Directive*[30] facilitating cross-border banking services and transactions under coherent international conditions. Other relevant *Directives* included those on the monitoring and control of large exposures,[31] the reinforcement of prudential supervision,[32] deposit guarantee schemes[33] and financial conglomerates.[34]

Of particular importance is the European legislation on the capital requirements of credit institutions[35] following the Basel Capital Accords of the BIS-based Basel Committee on Banking Supervision. The Basel Capital Accord ("Basel I")[36] of 1988 was transposed into European law by the 1989 *Directives* on own funds[37] and on the solvency ratio[38] of credit institutions. In a nutshell, it stipulated a minimum capital ratio (*i.e.*, capital to assets) of eight percent by the end of 1992 in order to protect internationally active banks against credit or counterparty risks. As an additional safeguard, Basel I distinguished between two tiers of regulatory capital, namely core capital ("Tier 1"), mostly made up of shareholders' equity, and supplementary capital ("Tier 2"), including, *e.g.*, hybrid instruments such as convertible bonds, and provided for a Tier 1-requirement of four percent, as a minimum.

The second Basel Accord of June 2004 ("Basel II")[39] broadened the scope of Basel I by introducing new mechanisms and instruments for banking regulation and supervision in Pillar II and Pillar III. The minimum capital requirements, dealt with in Pillar I, were redesigned to cushion not only credit risks, but also market and operational risks. In addition, the new rules allow for greater flexibility in determining the risk-weight attributed to a risky asset by making available three distinct risk measurement methods: basic, standardized approaches as well as more advanced and more risk-sensitive approaches based on internal methods of credit institutions (so-called "internal ratings-based approach", IRB). In Pillar II, Basel II

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29 *White Paper* COM(85) 510 final of 14/6/1985.

30 *Directive* 89/646/EEC of 30/12/1989, amending *Directive* 77/780 EEC, *supra*, n. 26.

31 *Directive* 92/121/EEC of 21/12/1992.

32 *Directive* 95/26/EC of 29/6/1995.

33 *Directive* 94/19/EC of 30/5/1994, recently amended by *Directive* 2009/14/EC of 11/3/2009 as regards to the coverage level (raised from € 20,000 to € 100,000) and the payout delay.

34 *Directive* 2002/87/EC of 16/12/2002.

35 For a list of EU legislation in this area see online: <http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm>.

36 Available online: <http://www.bis.org/publ/bcbsc111.htm>; for detailed analysis see Jan H. Dalhuisen, "Financial Services, Products, Risks and Regulation in Europe after the EU 1998 Action Plan and Basle II" (2007) Business Law Review 819 at 1018 *et seq*.

37 *Directive* 89/299/EEC of 17/4/1989.

38 *Directive* 89/647/EEC of 30/12/1989.

39 Online: <http://www.bis.org/publ/bcbsca.htm>; for critical assessment see Avinash Persaud, "The Political Economy of Basle II" (2003) European Business Law Review 219; Jan H. Dalhuisen, "Financial Services, Products, Risks and Regulation in Europe after the EU 1998 Action Plan and Basle II", *supra*, n. 36 at 1032 *et seq*.

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provides for a special process of continuous supervisory review, thereby adding a qualitative element to the quantitative requirements of the first pillar. Finally, Pillar III expands existing disclosure requirements in order to provide for enhanced market discipline.[40]

The EU, in contrast to the U.S., implemented Basel II early in 2006 by the *Banking Directive* and the *Capital Adequacy Directive*, both commonly referred to as the *Capital Requirements Directive* (CRD),[41] and, also in contrast to the U.S., extended the application of the revised framework to all credit institutions, regardless of their size, international scope of business etc. However, as a consequence of the financial crisis, a new EU *Directive* known as "CRD II"[42] introduced some changes to the CRD (now commonly referred to as "CRD I"), and further extensive changes are already under way. These crisis-related developments will be described in more detail *infra*, part 5.

Other European legislation relevant to the banking industry includes the 2005 *Directive* on the prevention of money laundering and terrorist financing,[43] the 2007 *Directive* on payment services[44] and the 2009 *Directive* on the business of electronic money.[45]

(c) Securities Regulation and Regulation of Related Financial Services

Specific European legislation in securities trading and related financial services started in the late 1970s with the long-term objective of promoting the free movement of capital (former Articles 56 to 60 TEC, now Articles 63 to 66, 75 TFEU) and the freedom of establishment (former Articles 43 to 48 TEC, now Articles 49 to 54 TFEU) within an integrated European securities market. The earliest *Directives* included those coordinating the conditions for the admission of securities to official stock exchange listing, the listing particulars to be published for such

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40 See the introductory section of Basel II, para. 4, online: <http://www.bis.org/publ/bcbs107.htm>.

41 *Directives* 2006/48/EC of 14/6/2006 relating to the taking up and pursuit of the business of credit institutions and 2006/49/EC of 14/6/2006 on the capital adequacy of investment firms and credit institutions; see also *Directives* 2009/27/EC of 7/4/2009 and 2009/83/EC of 27/7/2009 amending certain Annexes to *Directives* 2006/48/EC and 2006/49/EC as regards technical provisions concerning risk management.

42 *Directive* 2009/111/EC of 16/9/2009 amending *Directives* 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management. This *Directive* is to be transposed into national law until 31/10/2010; see The Department of Company Law, Leiden University, The Netherlands, "Survey of Legislation and Case Law, November 2009-February 2010" (2010) European Company Law 128.

43 *Directive* 2005/60/EC of 26/10/2005; see also earlier *Directives* 91/308/EEC of 10/6/1991 and 2001/97/EC of 4/12/2001.

44 *Directive* 2007/64/EC of 13/11/2007, amending earlier *Directives* 97/7/EC of 20/5/1997, 2002/65/EC of 23/9/2002, 2005/60/EC of 26/10/2005, 2006/48/EC of 14/6/2006 and repealing *Directive* 97/5/EC of 27/1/1997.

45 *Directive* 2009/110/EC of 16/9/2009.

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admission and relevant information to be published by stock market companies.[46] Subsequent *Directives* targeted, *inter alia*, the coordination of collective investment in transferable securities (UCITS),[47] the information to be published when major holdings in listed companies are acquired or disposed of,[48] the requirements for a prospectus when transferable securities are offered to the public[49] and a first coordination of regulations on insider dealing.[50] Another decisive hurdle was then cleared with the 1993 *Directives* on investment services in the securities field[51] and the capital adequacy of investment firms,[52] followed by the 1997 *Directive* on investor-compensation schemes[53] and the 1998 *Directive* on settlement finality in payment and securities settlement systems.[54]

The implementation of the FSAP until 2004, supported by the introduction of the Lamfalussy procedure, resulted in a wave of modernized *Directives* and *Implementation Directives* on, *e.g.*, insider dealing and market manipulation (market abuse),[55] takeover bids,[56] transparency requirements for issuers listed on regulated markets, and for their shareholders,[57] the landmark *Directive* on markets in finan-

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46 See *Directives* 79/279/EEC of 5/3/1977, 80/339/EEC of 17/3/1980 and 82/121/EEC of 15/2/1982; all three Directives were subsequently repealed and modernized by *Directive* 2001/34/EC of 28/5/2001.

47 85/611/EEC of 20/12/1985 as amended by *Directives* 88/22/EEC of 22/3/1988, 95/26/EC of 29/6/1995, 2000/64/EC of 7/11/2000, 2001/107EC of 21/1/2002, 2001/108/EC of 21/1/2002, 2004/39/EC of 21/4/2004 and 2005/1/EC of 9/3/2005; see also *Implementation Directive* 2007/16/EC of 19/3/2007, Commission *Recommendation* 2004/383 EC of 27/4/2004 and *Directive* 2009/65/EC of 13/7/2009 (recast of the original *Directive* 85/611/EEC).

48 88/627/EEC of 12/12/1988, repealed by *Directive* 2001/34/EC of 28/5/2001; in this context see also *Directive* 2003/58/EC of 15/7/2003 as regards disclosure requirements in respect of certain types of companies.

49 89/298/EEC of 17/4/1989, repealed by *Directive* 2003/71/EC of 4/11/2003; see also *Implementation Regulation* (EC) No. 809/2004 of 29/4/2004.

50 89/592/EEC of 13/11/1989, repealed by *Directive* 2003/6/EC of 28/1/2003, *infra*, n. 55.

51 93/22/EEC of 10/5/1993, repealed by *Directive* 2004/39/EC of 21/4/2004.

52 93/6/EEC of 15/3/1993, amended by *Directive* 2004/39/EC of 21/4/2004. This *Directive* was also relevant to credit institutions if their trading-book business in securities exceeded 5% of their total business.

53 97/9/EC of 3/3/1997.

54 98/26/EC of 19/5/1998, as amended by *Directive* 2009/44/EC of 6/5/2009.

55 2003/6/EC of 28/1/2003, followed by *Implementation Directives* 2003/124/EC of 22/12/2203, 2003/125/EC of 22/12/2003, 2004/72/EC of 29/4/2004 and *Regulation* (EC) No. 2273/2003 of 22/12/2003.

56 2004/25/EC of 21/4/2004; for details on the implementation process of this *Directive* see Peter O. Mülbert, in: Walther Hadding, Klaus J. Hopt & Herbert Schimansky (ed.), *Vermögensverwaltung — Übernahmerecht im Gefolge der Übernahmerichtlinie: Deutschland, Bankrechtstag 2006* (Berlin/New York: de Gruyter, 2007) at 141 *et seq*.; Peter O. Mülbert, "Umsetzungsfragen der Übernahmerichtlinie", (2004) Neue Zeitschrift für Gesellschaftsrecht 633.

57 So-called *Transparency Directive* 2004/109/EC of 15/12/2004, followed by *Implementation Directive* 2007/14/EC of 8/3/2007.

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cial instruments (MiFID)[58] and the so-called *Acquisitions Directive*,[59] designed to improve the supervisory approval process for mergers and acquisitions in the banking, insurance and securities sectors. The important 2002 *Regulation* on the application of international accounting standards[60] should also be mentioned in this context.

4. A STRONGER, MORE COORDINATED SUPERVISORY ARCHITECTURE

The financial crisis revealed serious deficiencies in the existing financial and banking supervisory structures as well as the institutional framework at the level of EU Member States and the EU. As a consequence, the European Commission requested a group of high level experts, chaired by former Managing Director of the International Monetary Fund (IMF) *Jacques de Larosière*, to analyze potential systemic failures and make proposals with the objective of establishing a more efficient, integrated and sustainable supervisory architecture within the European Union.[61] The *Larosière Group* presented its final report in February 2009.[62] In particular, it criticized an absence of adequate macro-prudential supervision, ineffective early warning mechanisms, a lack of powers, cooperation and frankness at both national and international levels, failures to challenge supervisory practices on a cross-border basis, inconsistent supervisory powers across the Member States, insufficient resources of committees acting within the Lamfalussy process (*i.e.*, CESR, CEBS and CEIOPS) and the existence of considerable impediments for supervisors to take joint decisions.[63] Building on the group's analysis and recommendations, in May 2009 the European Commission presented detailed proposals[64] for *Regulations* establishing a new supervisory architecture resting on two pillars: a new European System of Financial Supervision (ESFS) and an innovative European Systemic Risk Board (ESRB).[65] In September 2010, following a rather con-

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58 2004/39/EC of 21/4/2004, followed by *Implementation Directive* 2006/73/EC of 10/8/2006 and supplementary *Regulation* (EC) No. 1287/2006 of 10/8/2006.

59 2007/44/EC of 5/9/2007.

60 *Regulation* (EC) No. 1606/2002 of 19/7/2002.

61 See *e.g.*, Edoardo Chiti, "An Important Part of the EU's Institutional Machinery: Features, Problems and Perspectives of European Agencies" (2009) Common Market Law Review 1395 at 1427 *et seq*.

62 Online: <http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf>.

63 *Ibid.*, at 39 *et seq*.

64 Commission communication COM (2009) 252 final of 27/5/2009 on European financial supervision, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52009DC0252:EN:NOT>.

65 See Eddy Wymeersch, "The reforms of the European Financial Supervisory System" (2010) European Company and Financial Law Review 240 at 250 et seq.; Marco Lamandini, "When More Is Needed: The European Financial Supervisory Reform and Its Legal Basis" (2009) European Company Law 197 at 199 *et seq*. See also Pablo Iglesias Rodríguez, "Towards a new European financial supervision architecture" (2009) 16 Columbia Journal of European Law Online 1, online: <http://www.cjel.net/online/16_1-rodriguez/>; Niamh Moloney, "EU financial market

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troversial debate, the Commission, Parliament and Council finally agreed on the new supervisory architecture.

(a) The European System of Financial Supervision (ESFS)

The ESFS is to become a strong network of national institutions and independent European Supervisory Authorities (ESAs). It will feature a new Paris-based European Securities and Markets Authority (ESMA),[66] a London-based European Banking Authority (EBA)[67] and a Frankfurt-based European Insurance and Occupational Pensions Authority (EIOPA),[68] designed as upgraded replacements for the CESR, CEBS and CEIOPS. Every ESA is to receive a legal personality and be comprised of a central Board of Supervisors, a Management Board, a Chairperson, an Executive Director and a Board of Appeal.[69] The Board of Supervisors as the main decision-making body will be composed of voting members (*i.e.*, heads of national supervisors, who are to act objectively and to repudiate any instruction given by third parties) and non-voting members (*i.e.*, the head of each respective ESA, one representative each from the ESRB, EBA and EIOPA, as well as a representative from the Commission),[70] whereas the Management Board, being assigned significant ancillary and organizational tasks, will consist of the Chairperson, a European Commission representative and four members elected by the Board of Su-

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regulation after the global financial crisis: 'more Europe' or more risks?" (2010) Common Market Law Review 1317 at 1332 *et seq.*; Klaus J. Hopt, "Auf dem Weg zu einer neuen europäischen und internationalen Finanzmarktarchitektur" (2009) Neue Zeitschrift für Gesellschaftsrecht 1401 at 1404 *et seq.*; Matthias Lehmann & Cornelia Manger-Nestler, "Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht" (2010) Europäische Zeitschrift für Wirtschaftsrecht 87; René Partsch, "Die Harmonisierung der Europäischen Finanzaufsicht" (2010) Zeitschrift für Bank- und Börsenrecht 72. For an international (comparative) approach to reforms of supervisory architectures see Donato Masciandaro, "Regulating the Regulators: The Changing Face of Financial Supervision Architectures before and after the Crisis" (2009) European Company Law 187; Thomas Schmitz-Lippert, "International Co-operation between Financial Supervisory Authorities" (2010) European Company and Financial Law Review 266. See also Peter O. Mülbert, "Finanzmarktregulierung — Welche Regelungen empfehlen sich für den deutschen und europäischen Finanzsektor?" (2010) Juristen-Zeitung 834.

66 *Regulation* (EU) No. 1095/2010 of 24/11/2010, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0084:0084:EN:PDF>; see also online: <http://www.esma.europa.eu>.

67 *Regulation* (EU) No. 1093/2010 of 24/11/2010, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0012:0047:EN:PDF>; see also online: <http://www.eba.europa.eu>.

68 *Regulation* (EU) No. 1094/2010 of 24/11/2010, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0048:0083:EN:PDF>; see also <http://www.eiopa.europa.eu>.

69 As to the internal governance of the new authorities see also Eddy Wymeersch, "The reforms of the European Financial Supervisory System", *supra*, n. 65 at 261 *et seq.*

70 See Art. 40, 42 of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68.

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pervisors. In total, the staff of each ESA is expected to comprise between 40 and 60 people during the first year and will grow to about 100 within three years.

The functions[71] and responsibilities of each ESA will exceed those of the CESR, CEBS or CEIOPS. In particular, they will include the development of two types of draft technical standards — regulatory technical standards (RTFs) and implementing technical standards[72] — in the areas specified in the respective ESA *Regulation*,[73] which will become legally binding as a regulation upon formal adoption by the Commission.[74] In addition, the ESAs are tasked with enforcing a consistent application of European rules by national supervisors, *inter alia*, by issuing guidelines and recommendations addressed to national supervisors and by carrying out investigations and issuing recommendations following a breach of EU law by a competent (national) authority. Moreover, the ESAs may issue a binding settlement order in case of a disagreement between national authorities in cross-border situations, and may act to stabilize financial markets in emergency situations (as determined by the Council) based on special powers for specific actions against national authorities.[75] Special powers may encompass whatever decision is necessary to restore stability and an orderly functioning of the financial markets. If a supervisory authority does not comply with an emergency order to intervene, the respective ESA itself may address market participants (such as financial institutions) and require them to take necessary action, up to the cessation of any practice.[76] However, decisions adopted must not impinge in any way on the fiscal responsibilities of Member States.[77] Finally, Parliament successfully pushed for special powers of ESAs concerning consumer protection, *e.g.*, to investigate special types of financial institutions, products or activities and issue warnings or even temporary bans,

71 Functions are defined under Art. 8(1) of *Regulation* (EU) No. 1095/2010, *supra*, n. 66, and Art. 8(1) of *Regulation* (EU) No. 1093/2010, *supra*, n. 67.

72 Regulatory technical standards are delegated acts pursuant to Art. 290 TFEU that serve to ensure consistent harmonization of a basic legislative act, whereas implementing technical standards serve to ensure consistent implementation of legally binding *Union Acts* (*i.e., Regulations*), see Art. 291 TFEU.

73 For instance, the ESMA is to act exclusively within the scope of those *Directives* mentioned under recital 18 and Art. 1(2) of *Regulation* (EU) No. 1095/2010, which include, *e.g.*, areas of MiFID (2004/39/EC), the Capital Requirements Directive (2006/49/EC) and the Transparency Directive (2004/109/EC). The ESMA will also play a leading role in the supervision of credit rating agencies, alternative investment funds, short selling, credit default swaps and OTC derivatives, subject to the respective regulatory legislation; *infra*, at parts 6(a) to 6(d).

74 However, the Commission has reserved the power to endorse standards only in part, or to make amendments. It is questionable whether this will actually lead to effective, accountable and independent rule-making by the ESMA; for similar criticism see Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2273.

75 See Art. 18, 19 of *Regulation* (EU) No. 1095/2010, *supra*, n. 66, and Art. 18, 19 of *Regulation* (EU) No. 1093/2010, *supra*, n. 67; Eddy Wymeersch, "The reforms of the European Financial Supervisory System", *supra*, n. 65 at 259 *et seq*.

76 Art. 18(4) of *Regulations* (EU) No. 1095/2010 and 1093/2010, *supra*, n. 66 and 67.

77 Art. 38 of *Regulation* (EU) No. 1095/2010, *supra*, n. 66.

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where necessary.[78]

The Executive Director will exercise a variety of management functions,[79] and the Board of Appeal as an impartial joint body of all ESAs will protect the rights of parties affected by the supervisory decisions and provide adequate remedies.[80] Furthermore, there will be a special Joint Committee of all ESAs to ensure cross-sectoral cooperation and enhance mutual understanding, cooperation and consistent supervisory approaches.[81]

The *Regulations* setting up the ESFS and ESAs will enter into force and allow the authorities to begin their work in January 2011. Although the new supervisory architecture has largely been welcomed and expected to modernize and improve the current legislative procedure established under *Lamfalussy*, some critics have voiced serious concerns regarding the quality of its multipolar rule-making structure, suspecting that institutional mistakes of the past might be repeated on an even larger scale.[82] However, in light of the myriad ways in which supervision has traditionally been organized at pan-EU national levels[83] and given some Member States' deep-rooted aversion to entirely relinquish regulatory control over fiscally sensitive capital markets, a more intrusive institutional reform (*e.g.*, in the form of an omnibus EU entity) has never been a realistic option, although the new *Regulations* clearly envisage that the ESAs' powers may well be expanded over time.[84] Still, even a limited transfer of regulatory powers from national authorities to EU institutions might make the latter a convenient scape-goat for Member States with respect to any subsequent regulatory failures.[85]

(b) The European Systemic Risk Board

With respect to macroeconomic supervision, the European Union will establish an entirely new, unprecedented institution, named the European Systemic Risk

78 See Art. 9 of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68.

79 Art. 51 *et seq*. of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68.

80 Art. 58 *et seq*. of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68.

81 Art. 54 *et seq*. of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68; see also Matthias Lehmann & Cornelia Manger-Nestler, "Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht", *supra*, n. 65 at 88 *et seq*.

82 Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", supra, n. 18 at 2274.

83 Eddy Wymeersch, "The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors" (2007) 8 European Business Organization Law Review 237.

84 See the review clauses in Art. 81 of *Regulations* (EU) No. 1095/2010, 1093/2010 and 1094/2010, *supra*, n. 66, 67 and 68, which assign the Commission to file respective evaluation reports.

85 For a similar perception see Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2271.

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Board (ESRB), on the basis of Article 114 TFEU.[86] The respective *Regulation* resembles to some extent the U.S. Government's plans for creating a new Financial Services Oversight Council[87] and focuses on the ESRB as an independent body without legal personality, drawing its legitimacy from an alleged "reputation for independent judgments, high quality analysis and sharpness in its conclusions".[88] Perhaps most importantly, the ESRB will be responsible for the detection, prevention and mitigation of systemic risks within the financial system, issue warnings where risks are deemed to be too significant, provide recommendations for remedial action where appropriate, monitor the follow-up to such warnings and recommendations, cooperate with ESFS authorities and coordinate with the IMF, the Financial Stability Board (FSB) and competent bodies in third countries.[89] Although ESRB recommendations will not be legally binding, the respective addressees (the EU, Member States, ESAs or national supervisory authorities) cannot remain passive, but are put under pressure to "act or explain".[90] Furthermore, subject to Article 18 of the *Regulation*, it will be decided on a case-by-case basis whether a warning or recommendation should be made public.[91]

The ESRB will feature a tripolar organizational structure with a General Board, a Steering Committee and a Secretariat, advised and assisted by an ancillary Advisory Technical Committee and — based on recent amendments introduced by Parliament — an Advisory Scientific Committee.[92] The General Board will be entrusted with decision-making, its Members being the President and the Vice-President of the ECB, the Governors of the 27 national central banks, a Member of the European Commission, the Chairpersons of the EBA, ESMA and EIOPA, the Chair

86 See *Regulation* (EU) No. 1092/2010 of 24/11/2010, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:331:0001:0001:EN:PDF>. For an overview see Eddy Wymeersch, "The reforms of the European Financial Supervisory System", *supra*, n. 65 at 250 *et seq*.; Chryssa Papathanassiou & Georgios Zagouras, "Mehr Sicherheit für den Finanzsektor: der Europäische Ausschuss für Systemrisiken und die Rolle der EZB" (2010) Zeitschrift für Wirtschaftsund Bankrecht 1584.

87 U.S. Department of the Treasury, "Financial Regulatory Reform — A New Foundation: Rebuilding Financial Supervision and Regulation", online: <http://www.financialstability.gov/docs/regs/FinalReport_web.pdf>; for an in-depth analysis from a comparative point of view see Giovanna De Minico, "Regulators and Rules — President Obama's Reforms vs Europe's Reforms" (2010) European Business Law Review 451.

88 For this quotation see the September 2009 Commission proposal COM (2009) 499 final, available online: <http://ec.europa.eu/internal_market/finances/committees/index-en.htm> at 4.

89 Arts. 3, 15 *et seq*. of *Regulation* (EU) No. 1092/2010, *supra*, n. 86.

90 *Regulation* (EU) No. 1092/2010, *supra*, n. 86, at recital 20. Of course, it is a moot point whether these powers will actually suffice to prevent future crises; see Klaus J. Hopt, "Auf dem Weg zu einer neuen europäischen und internationalen Finanzmarktarchitektur", *supra*, n. 65 at 1405.

91 See also recital 21 of *Regulation* (EU) No. 1092/2010, *supra*, n. 86.

92 Art. 4 of *Regulation* (EU) No. 1092/2010, *supra*, n. 86. As to the Advisory Scientific Committee see Art. 12 of *Regulation* (EU) No. 1092/2010, *supra*, n. 86.

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and the two Vice-Chairs of the Advisory Scientific Committee, the Chair of the Advisory Technical Committee and, albeit without voting rights, the President of the Economic and Financial Committee (EFC)[93] and one high level representative per Member State of the competent national supervisory authorities.[94] In total, the General Board will comprise more than 30 voting Members. Admittedly, this number raises doubts as to the practicability and effectiveness of the decision-making process.[95]

The Steering Committee will consist of the Chairperson and first Vice-Chairperson of the ESRB, four other members of the General Board, a Member of the Commission, the President of the Economic and Financial Committee, the Chairpersons of the EBA, ESMA and EIOPA and the Chairs of the Advisory Scientific and the Advisory Technical Committee. The Committee is to assist and support the decision-making process by preparing the General Board's meetings.

The Secretariat, which will provide administrative, logistical, statistical and analytical support under the direction of the General Board's Chairperson, will be established with the ECB in order to exploit its in-depth macro-prudential expertise and central role in the monetary system.[96]

On Parliament's initiative, an additional provision was introduced allowing the ESRB, in collaboration with the ESAs, to develop a common set of qualitative and quantitative indicators serving as a basis to assign supervisory rating to cross-border financial institutions which might pose a systemic risk. Furthermore, in order to enhance the awareness of risks within the European economy and to prioritize them, the ESRB will establish a color-coded system corresponding to situations of different risk levels. Thirdly, Parliament successfully pushed for the ESRB to be chaired by the ECB President for a term of five years from its establishment. For subsequent terms the Chair will be chosen following a review process.

5. POST-CRISIS DEVELOPMENTS IN BANKING REGULATION

Changes to the banking regulation framework at the EU level in response to the financial crisis are numerous. In the following section, a whole range of legislative measures recently enacted, adopted, proposed by the Commission or at the planning stage are described. Raising the capital standards of financial institutions, currently regulated under the *Capital Requirements Directive*'s regime as predetermined by the Basel Capital Accords,[97] is of prime concern.

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93 The EFC is an important advisory committee to ECOFIN and successor to the former Monetary Committee established under Article 114 TEC.

94 As to voting rights and procedures, necessary majorities and the overall internal organization of the General Board see Arts. 5 *et seq*. of *Regulation* (EU) No. 1092/2010, *supra*, n. 86.

95 Klaus J. Hopt, "Auf dem Weg zu einer neuen europäischen und internationalen Finanzmarktarchitektur", *supra*, n. 65 at 1405.

96 See also the ancillary *Regulation* entrusting the ECB with specific tasks concerning the functioning of the ESRB ("ECB *Regulation*"), available online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri= OJ:L:2010:331:0162:0164:EN:PDF>.

97 *Supra*, at part 3(b).

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(a) Securitization (CRD II)

Directive 2009/111/EC of September 2009, also referred to as "CRD II", has in the main amended the regulatory treatment of securitizations which are designed to transfer credit risks, such as mortgage-backed securities, as a reaction to certain market deficiencies that had been revealed during the financial crisis. In particular, the *Directive* is intended to improve risk management, prevent inadequate incentives and remove the misalignment between the interests of firms that re-package loans into tradable securities and other financial instruments (referred to as originators or sponsors) and firms that invest in these assets.[98]

For this purpose, originators (sponsors) are now required to apply the same sound and well-defined criteria for credit-granting as they would apply to exposures to be held on their own book.[99] They are also to retain, on an ongoing basis,[100] a significant "net economic interest" of at least five percent in the credit risk inherent in the securitization's underlying assets, *e.g.*, to the re-packaged loans in question.[101] The only exemption from this rule applies if the securitized exposures are claims (or contingent claims) on certain third parties of distinct solvency (*e.g.*, national governments, central banks or local authorities) or are fully, unconditionally and irrevocably guaranteed by such parties.[102] In cases of non-compliance, originators are not entitled to exclude the securitized exposures from the calculation of their capital requirements under the CRD,[103] which acts as a deterrent.

Furthermore, originators are bound to disclose to investors the level of their commitment to retain a "net economic interest" in the securitization and ensure that prospective investors have readily available access to all relevant data on the credit quality and performance of the individual underlying exposures, cash flows and collateral supporting a securitization exposure, as well as such information as is necessary to conduct stress tests on the cash flows and collateral values supporting the underlying exposures.[104]

Investing credit institutions, on the other hand, must be able to demonstrate that they have a comprehensive and thorough understanding of their investments and have implemented formal policies and procedures for the analysis of credit risks.[105] This is to include the regular performance of internal stress tests appropriate to their securitization positions[106] and the comprehension of all structural fea-

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98 See recital 10 of CRD II, *supra*, n. 42.

99 Art. 122a (6) CRD, *supra*, n. 41, as added by CRD II.

100 This means that retained positions, interest or exposures cannot be hedged or sold.

101 Art. 122a (1) and (6) CRD, *supra*, n. 41, as added by CRD II; see also recital 24 of CRD II. This is in agreement with the G20 leaders' statement issued at the Pittsburgh summit of September 2009, at 7, para. 12, online: <http://www.pittsburghsummit.gov/documents/organization/129853.pdf>.

102 Art. 122a (3) CRD, *supra*, n. 41, as added by CRD II.

103 Art. 122a (6) CRD, *supra*, n. 41, as added by CRD II.

104 Art. 122a(7) CRD, *supra*, n. 41, as added by CRD II.

105 See Art. 122a(4) CRD, *supra*, n. 41, as added by CRD II.

106 *Ibid.* For this purpose, financial models developed by credit rating agencies may be relied on provided that the credit institutions can demonstrate, when requested, that

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tures of a securitization transaction that would materially impact the performance of the institution's exposures to that transaction.[107] Investment decisions may only be taken after having conducted thorough due diligence, for which institutions must obtain adequate information about each respective product. In addition, performance information on the exposures underlying acquired securitization positions must be monitored on an ongoing basis and in a timely manner.[108] Violations of these requirements may result in an order by national supervisory authorities to apply a risk weight of up to 1,250 percent for the investment position at stake.[109]

In consequence of the new *Directive*, originators' refinancing costs may rise considerably, partly because investors will likely demand higher margins as a compensation for the additional organizational efforts and expenditures they will incur; this may also incentivize originators to choose simpler securitization structures in order to appeal to a wider range of investors. At the same time, the provisions might discriminate against smaller banks which, in contrast to larger competitors, will be constrained in their risk diversification due to a lack of organizational resources necessary to handle more complex securitizations. Moreover, particular product categories will probably be designed for exclusive distribution to third-country investors which will not be subject to the CRD II-mandated requirements for credit institutions investing in securitizations. It remains to be seen whether the new provisions will thus create a competitive disadvantage for the European banking industry as a whole.

National legislators are obliged to transpose the *Directive* into national law by October 31, 2010, with their content taking effect no later than the end of December 2010. However, the new rules will only apply to securitizations issued on or after January 1, 2010. As from January 2015, they will apply to existing securitizations when new underlying exposures are added or substituted after that date.[110] In addition, the CEBS published a consultation paper on guidelines to the new securitization regime.[111]

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they took due care prior to investing to validate the relevant assumptions in and structuring of the models and to understand methodology, assumptions and results.

107 For example: contractual waterfall and waterfall related triggers, credit enhancements, liquidity enhancements, market value triggers and deal-specific definition of default; see Art. 122a(5) subpara. 2 CRD, supra, n. 41, as added by CRD II.

108 Monitoring is to be focussed on the exposure type, the percentage of loans more than 30, 60 and 90 days past due, default rates, prepayment rates, loans in foreclosure, collateral type and occupancy, and frequently distribution of credit scores or other measures of credit worthiness across underlying exposures, industry and geographical diversification, frequency distribution of load to value ratios with band widths that facilitate adequate sensitivity analysis. If the underlying exposures are themselves securitization positions, institutions are to have this information not only on the underlying securitization tranches (*e.g.*, issuer name and credit quality), but also on the characteristics and performance of the pools underlying those tranches; see Art. 122a(5) CRD, *supra*, n. 41, as added by CRD II.

109 Art. 122a (5) CRD, *supra*, n. 41, as added by CRD II.

110 Art. 122a (8) CRD, *supra*, n. 41, as added by CRD II.

111 Online: <http://www.eba.europa.eu/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP40.aspx>.

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(b) Capital Requirements

In July 2009, the Commission published proposals for yet another *Directive* (referred to as "CRD III") to supplement the existing CRD framework with, *inter alia*, capital requirements for assets held by banks on their trading book for short-term resale and capital requirements for complex re-securitizations.[112]

Aligned with what is envisaged by the Basel Committee,[113] this Commission proposal is going to change the way that credit institutions assess the risks connected with their trading book positions in order to reflect potential losses from adverse market movements. First, the Commission intends to roughly double current trading book capital requirements by adapting them to those for equivalent securities on the banking book and tightening the standards for internal models used to calculate relevant market risks. Second, there will be an extension of the existing requirement for default risks on the trading book to reflect losses short of issuer default, such as rating downgrades. Third, the requirement for securitization positions in the trading book will be based on the existing simple risk weights for the banking book. And finally, a novel feature is that CRD disclosure requirements are to cover not only the risks of securitization positions in the non-trading book, but also those in the trading book. As a result of these enhanced capital requirements, the profitability of investment transactions will decrease, and hence credit institutions may shift the focus of their activities from proprietary trading to client-driven trading.

As regards re-securitizations,[114] which are deemed to have contributed considerably to recent capital market disruptions,[115] the proposals are clearly intended to discourage banks from extensive future investments. Under the existing CRD as amended by CRD II,[116] no distinction is made between ordinary securitization and re-securitization positions which have other securitization positions as underlying assets.[117] The Commission's proposal, depending on the complexity and credit-rating conditions, introduces special capital requirements for re-securitized products, ranging between 20 and 100 percent of each position, to reflect the risks inherent in them. The applicable due diligence requirements — also with respect to

112 COM (2009) 362 final of 13/7/2009, online: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0362:FIN:EN:PDF>.

113 See online: <http://www.bis.org/publ/bcbs134.htm>.

114 According to the Basel Committee's "Enhancements to the Basel II framework" (online: <http://www.bis.org/publ/bcbs157.pdf?noframes=1> at 2) the definition of "re-securitization", *inter alia*, captures collateralized debt obligations (CDSOs) of asset-backed securities (ABS) including, *e.g.*, a CDO backed by residential mortgage-backed securities (RMBS). The high level of consistency between Basel II and the CRD strongly implies that the Commission proposal implicitly adopts this understanding; see the relevant at 6, recital 14 *et seq*., Art. 1(1) and (9) and Annex I, para. (3) of COM (2009) 362 final, *supra*, n. 112.

115 See COM (2009) 362 final, *supra*, n. 112 at 3.

116 *Supra*, part 4(a).

117 See the Commission's impact assessment to CRD III of 13/7/2009, SEC (2009) 974 final, at 15, online: <http://ec.europa.eu/internal_market/bank/docs/regcapital/com2009/impact_assesment_en.pdf>.

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underlying securitizations — and supervisory procedures will be strict. And if, in exceptional cases, a bank cannot demonstrate that it has complied with them in respect of any highly complex product, the maximum risk weight of 1,250 percent must be applied. However, this latter aspect would only apply to new re-securitizations issued after December 31, 2010 and to existing re-securitizations as of December 31, 2014 if new underlying exposures are added or substituted after that date.

In July 2010, the European Parliament approved the Commission's 2009 proposal with slight amendments concerning the exclusion of correlation trading from the new trading book requirements, as also envisaged by the Basel Committee,[118] and the Council adopted this version in October 2010.

(c) Remuneration Policies

The current EU regulatory framework does not provide for any mandatory rules concerning remuneration policies. Notwithstanding the Commission having published two non-binding *Recommendations* on remuneration issues in April 2009,[119] few Member States have as yet amended their national laws to the standards envisaged therein,[120] or are at least prepared to do so. Therefore, the Commission also included a variety of binding amendments regarding remuneration in its July 2009 CRD III proposals[121] which are in line with the FSB Principles for Sound Compensation Practices — Implementation Standards[122] and the principles for remuneration policies published by CEBS in April 2009.[123]

In essence, the Commission proposal supplements the requirements of the CRD by an express obligation of credit institutions and investment firms to establish and maintain, for those categories of staff whose professional activities have a

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118 See the amended proposal online: <http://www.europarl.europa.eu /sides/getDoc.do?type=TA&reference=P7-TA-2010-0274&language=EN&ring=A7-2010-0205>; see also Parliament's explanatory remarks, online: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=//EP//NONSGML+COMPARL+PE-439.301+03+DOC+PDF+V0//EN&language=EN> at 13/57 and 34/57.

119 Commission *Recommendations* COM (2009) 3159 and COM (2009) 3177 of 30/4/2009 as regards remuneration policies in the financial services sector and the regime for the remuneration of directors of listed companies, online: <http://ec.europa.eu/internal_market/company/docs/directors-remun/financialsector_290409_en.pdf> and <http://ec.europa.eu/internal_market/company/docs/directors-remun/directorspay _290409_en.pdf>.

120 See Commission Press Release, "Commission proposes improved EU supervision of Credit Rating Agencies and launches debate on corporate governance in financial institutions" of 2/6/2010, available online: <http://ec.europa.eu/internal_market/securities/agencies/index_en.htm>.

121 COM (2009) 362 final, *supra*, n. 112.

122 Online: <http://www.financialstabilityboard.org/publications/r_090925c.pdf>. The FSB Principles are a follow-up to the FSF Principles for Sound Compensation Practices of April 4, 2009, online: <http://www.financialstabilityboard.org/publications/r_0904b.pdf>.

123 Online: <http://www.c-ebs.org/getdoc/34beb2e0-bdff-4b8e-979a- 5115a482a7ba/High-level-principles-for-remuneration-policies.aspx>.

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material impact on the firm's risk profile,[124] remuneration policies and practices that are consistent with effective risk management.[125] To that end, the proposal lays down a series of rather abstract high-level principles.[126] For instance, remuneration policies must be consistent with and promote sound and effective risk management and must not encourage risk-taking that exceeds the respective institution's level of tolerated risk. They are also to be in line with its business strategy, objectives, values and long-term interests. Where remuneration is performance related, the total amount must take into account the performance of the individual and the business unit concerned, and the overall results of the respective institution. Payments related to the early termination of a contract must reflect the performance achieved over the course of time and on no account reward failure. Fixed and variable remuneration components must be appropriately balanced, and the fixed component must represent a sufficiently high proportion to allow the operation of a fully flexible bonus policy, including an option to distribute no bonus at all. The calculation of bonuses is to include an adjustment for risks and observe the costs of capital and liquidity required, whilst payment of any significant bonus is to be deferred for an appropriate period and linked to the future performance of the firm. As regards the allocation of internal responsibilities, the management body (supervisory function) of each credit institution is to establish general remuneration principles and be entrusted with their implementation which is to be subject to independent compliance review at least annually.

According to the Commission, the proposals allow firms the discretion and flexibility to comply in a way that is "appropriate to their size, internal organization and the nature, the scope and the complexity of their activities".[127] Of course, given the high degree of abstractness of the proposals, the CEBS is called upon to ensure the development of more detailed guidelines in order to assist the firms affected and align national supervisory assessments.[128] However, it remains to be seen whether all Member States' contract laws will have mechanisms in place that allow firms to adapt existing employment contracts to the EU-mandated remuneration requirements — if need be, without the respective employees' consent.

National supervisors are to be responsible for identifying and imposing sanctions for infringements of the new remuneration principles. They may order financial institutions to rectify any inadequate remuneration structure or require them to hold additional own funds in order to safeguard against any inherent risk.[129] Moreover, Member States must ensure that national supervisors are vested with the power to impose additional financial and non-financial penalties (including fines)

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124 Naturally, this will primarily cover the senior management, but also employees assigned with control functions or risk taking in the ordinary course of business.

125 COM (2009) 362 final, *supra*, n. 112 at recital 3 and Art. 1(2)(a).

126 See Annex I of COM (2009) 362 final, *supra*, n. 112 at 19.

127 *Ibid.*

128 See COM (2009) 362 final, *supra*, n. 112 at 8 and 12 (recital 10).

129 The legal basis for such measures will be Art. 136(1) CRD, *supra*, n. 41, the scope of which is extended to cover remuneration requirements as inserted under Art. 22 CRD; see COM (2009) 362 final, *supra*, n. 112, at 8, Art. 1(2) and recital 8.

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for any breach of the new provisions.[130] Such measures and penalties, although not fleshed out in any detail, must be "effective, proportionate and dissuasive".[131]

In July 2010, the EU Parliament adopted the Commission proposal in principal, but suggested a variety of amendments.[132] Most importantly, Parliament advocates a much more rigorous approach with respect to bankers' bonuses: Financial institutions are required to defer between 40 percent and, in cases of "particularly high amounts" (which remains undefined), 60 percent of any "variable remuneration component" (*i.e.*, bonus) for three to five years, and half of any immediately payable bonus must be paid in shares, securities or other non-cash instruments linked to the institution's performance; as a result, staff may only receive between 20 and 30 percent of any bonus in upfront cash payment.[133] Not the least because of this, future EU rules on remuneration will go much further than any other jurisdiction.[134]

Credit institutions benefiting from exceptional government intervention are even more constrained in their discretion: the maintenance of a sound capital base, the timely exit from government support and the recovery of taxpayer assistance take priority and must be reflected by any remuneration scheme. Moreover, transparency has been declared a core issue as financial institutions must disclose detailed information on their remuneration policies which, according to Parliament, should also be made available to stakeholders, shareholders, employees and the general public.

Meanwhile, Parliament and Council have agreed on the new *Directive* to come into force based on the amendments suggested by Parliament. Relevant remuneration provisions will thus need to be implemented in national law by January 1, 2011.

(d) Deposit Guarantee Schemes

In July 2010, the Commission adopted a legislative proposal[135] for a revision of the *Directive* on deposit guarantee schemes.[136] It is intended to provide a transparent level playing field among credit institutions and to forestall the involvement of taxpayers' money in the case of a bank's collapse. At the same time, the confidence of depositors will be improved by allowing them to easily understand the features of deposit guarantee schemes, thereby reducing the probability of "bank

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130 COM (2009) 362 final, *supra*, n. 112 at 8 and Art. 1(3) in conjunction with new Art. 54(2) CRD.

131 Recital 8 of COM (2009) 362 final, *supra*, n. 112.

132 Online: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2010-0274+0+DOC+XML+V0//EN>.

133 See also Parliament's explanatory statement, online: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A7-2010-0208+0+DOC+XML+V0//EN#title2>.

134 See also Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2277.

135 COM (2010) 368 final, online: <http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm>.

136 *Directive* 94/19/EC of 30/5/1994.

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runs" by account holders who deem their savings to be at risk in times of economic stress.

If a bank has to face insolvency, the relevant guarantee scheme reimburses depositors up to a certain ceiling, which is currently set[137] (and will remain) at € 100,000. The key elements of the new proposal focus on a harmonization and simplification of protected deposits, faster payouts, less red tape, better information and an improved financing of schemes.

Until quite recently, mandatory deposit guarantee schemes within the EU have been extremely fragmented, featuring different internal structures with respect to, *inter alia*, relevant coverage levels or financing. The new *Directive* addresses this misalignment and, without exception, is intended to encompass all credit institutions and all guarantee schemes. Every credit institution in the EU must join a guarantee scheme, and there are no possible exemptions. On the other hand, for the purpose of the proposal, only entirely repayable instruments can be deemed to be "deposits". Structured products, certificates or bonds are excluded, which is said to prevent the schemes from taking unpredictable risks.[138]

Guarantee schemes will be obliged to reimburse depositors within one week and without any prior application being required.[139] In order to meet such short deadlines, the schemes will be entitled to obtain relevant information from credit institutions at an early stage, and the competent authorities must inform guarantee schemes by default if a bank failure becomes likely.[140] In addition, the proposal stipulates that unpaid claims on guarantee schemes can only be time-barred to the extent that the scheme's claims in the respective institution's liquidation or reorganization proceedings are time-barred.[141]

In order to facilitate the payout process in cross-border situations, *e.g.*, where deposits are made at branches of a credit institution domiciled in another Member State, the respective host country deposit guarantee scheme is to act as a single point of contact for depositors and deliver payment on behalf of the institution's home country scheme as a "paying agent".[142]

The financing of schemes is to follow a concept of up to four consecutive steps.[143] First, schemes must have 1.5 percent of eligible deposits on hand after a transition period of 10 years. This will be financed by contributions from participating credit institutions, which will be calculated primarily in accordance with their risk profile. Second, if these funds turn out to be insufficient in the event of a bank failure, participating institutions will be required to pay additional contributions of up to 0.5 percent of eligible deposits if necessary. Third, a mutual borrowing facility is to be set up to allow guarantee schemes in need to borrow from others, which must, if required, grant loans of up to 0.5 percent all told of the borrowing scheme's eligible deposits. That loan is then to be repaid within five years, and new

137 *Supra*, n. 33.

138 See Art. 2 of COM (2010) 368 final, *supra*, n. 136.

139 Recital 26 and Annex III of COM (2010) 368 final, *supra*, n. 135.

140 See COM (2010) 368 final, *supra*, n. 135 at 6 and 7.

141 Art. 8(4) of COM (2010) 368 final, *supra*, n. 135.

142 See COM (2010) 368 final, *supra*, n. 135 at 9.

143 Art. 9 and 10 of COM (2010) 368 final, *supra*, n. 135.

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contributions to the scheme must be raised to reimburse the loan. As a fourth line of defense, guarantee schemes will provide certain alternative funding arrangements.

As transparency and the enhancement of credibility in financial services are central to the Commission's proposal, depositors are to be informed about whether and to what extent their deposits are covered. Prior to making a deposit at a credit institution, depositors will be required to countersign an information leaflet containing all relevant information.[144] Existing depositors must be informed accordingly. Moreover, the guarantee schemes themselves must regularly disclose specific information on, for example, funds, capacity and regular stress tests which they will be obliged to perform.[145]

All schemes are to be subject to ongoing supervision, which is to some extent to be centralized and entrusted to the new EBA. Respective powers are to include the collection of information on the amount of deposits, the conducting of review analyses, the assessment of whether a guarantee scheme can borrow from others, and the settlement of disagreements between those schemes.[146] In this context, Member States will also be allowed to merge their guarantee schemes, if appropriate.[147]

Finally, as regards the forthcoming legislative procedures leading to enactment, the Commission intends to have most provisions of the proposal passed and put into force by the end of 2012.[148] However, in order to meet this goal, the Commission must still resolve several still contentious aspects. In particular, the Commission intends to bar Member States from covering consumer deposits above the protection ceiling of € 100,000.[149] Exceptions would only be available for deposits arising from real estate transactions for private residential purposes and deposits that are linked to particular life events such as marriage, divorce, invalidity or death of the depositor, provided that the coverage is limited to 12 months.[150] If this rule were to become binding, Member States such as Germany would probably have to supersede a variety of existing voluntary deposit guarantee schemes that cover much larger amounts, or as is the case with German schemes for savings and public sector banks as well as cooperative banks, protect the bank itself. On a different note, credit institutions fear that reimbursement within one week (instead of twenty days as is currently the case) might entail disproportionately high administrative costs.

(e) Further Upcoming Reforms

In February 2010, following intensive work by the Basel Committee, in partic-

144 Art. 14 and Annex III of COM (2010) 368 final, *supra*, n. 135.

145 See COM (2010) 368 final, *supra*, n. 135 at 9.

146 See recital 32 and explanatory remarks on 9 of COM (2010) 368 final, *supra*, n. 135.

147 COM (2010) 368 final, *supra*, n. 135 at 6.

148 See Art. 20 of COM (2010) 368 final, *supra*, n. 135.

149 Phrased in more technical terms, the proposal strives for full harmonization and the prevention of "gold-plating" by Member States.

150 COM (2010) 368 final, *supra*, n. 135 at 6.

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ular, the Commission launched a public consultation regarding further possible changes to the CRD ("CRD IV").[151] The Commission wishes to address liquidity standards for credit institutions and investment firms, reinforce capital requirements and definitions, regulate institutions' leverage ratio, amend the treatment of counterparty credit risks, impose a variety of counter-cyclical measures, ensure consistent prudential treatment of systemically important financial institutions and move towards a single rule book in European banking. These possible changes will reflect the July 2009 amendments to Basel II, *i.e.*, the "Revisions to the market risk frame-work"[152] and the "Enhancements to the Basel II framework",[153] and will also be closely aligned with the Basel III framework finalized by the Group of Governors and Heads of Supervision on September 12, *i.e.*, the capital requirements reform package and the introduction of a global liquidity standard.[154]

Apart from that, the Commission intends to develop broad legislative proposals on banks' corporate governance[155] and on cross-border crisis management in the banking sector.[156] With respect to crisis management, which has been a matter of national law up to now, the Commission launched a public consultation between October 2009 and January 2010, and in March 2010 hosted a high level expert conference on the topics of early supervisory intervention, effective means of bank resolution and respective insolvency frameworks.[157] Subsequently, a communication was released in May 2010, suggesting an EU network of bank resolution schemes, pre-funded by a levy on banks and designed to ensure that the failure of a credit institution is managed in an orderly manner and does not destabilize the financial system as a whole.[158] In contrast to some Member States, the Commission pursues a decidedly integrated European approach to effective crisis-management and denies, *inter alia*, exclusive supervisory powers of national authorities and ring-fencing, *i.e.*, the unilateral protection of credit institutions' assets in cases of

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151 Online: <http://ec.europa.eu/internal_market/consultations/2010/crd4_en.htm>.

152 Online: <http://www.bis.org/publ/bcbs158.htm>.

153 Online: <http://www.bis.org/publ/bcbs157.htm>.

154 See Group of Governors and Heads of Supervision announces higher global minimum capital standards, of September 12, 2010, online: <http://www.bis.org/bcbs/basel3.htm>.

155 See the Commission *Green Paper* COM (2010) 284 final of 2/6/2010 on corporate governance in financial institutions and remuneration policies, available online: <http://eur-lex.europa.eu/>. As to this document see Peter O. Mülbert, "Corporate Governance in der Krise" (2010) 174 Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht 375 at 376 *et seq*.; Klaus J. Hopt, "Europäische Corporate Governance für Finanzinstitute?" (2010) Europäische Zeitschrift für Wirtschaftsrecht 561; more generally Peter O. Mülbert, "Corporate Governance of Banks after the Financial Crisis — Theory, Evidence, Reforms", ECGI Law Working Paper No. 130/2009 (version of April 2010), available online: <http://ssrn.com/abstract=1448118>.

156 Online: <http://ec.europa.eu/internal_market/bank/crisis-management/index_en.htm>.

157 Pertinent documents are available online: <http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm>.

158 COM (2010) 254 final of 26/5/2010, online: <http://ec.europa.eu/internal_market/bank/docs/crisis-management/funds/com2010_254_en.pdf>. As to the problem of "too big to fail" in this context see *infra*, at part 7.

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insolvency.

Although no legislation on these issues has yet been sketched, the Commission intends to publish proposals between December 2010 and spring 2011 and is aiming for a binding adoption of most rules by the end of 2011, allowing for implementation in national law by the end of 2012.[159]

6. POST-CRISIS DEVELOPMENTS IN OTHER AREAS

Current crisis-driven regulatory issues in other areas include the European Union's legislation on: (a) credit rating agencies; (b) alternative investment funds; (c) OTC derivatives and market infrastructures; (d) short selling and credit default swaps; and (e) miscellaneous other legislative projects.

(a) Credit Rating Agencies

Even prior to the financial crisis, the idea of establishing tough regulations for (U.S.) credit rating agencies occupied a prominent place on the EU's political agenda. The financial crisis then swept away previously predominant doubts as to the feasibility of regulating the large U.S.-based credit rating agencies. These were universally "credited" with having paved the way to and into the crisis because of rampant conflicts of interests resulting from pre-rating advice, certain other consultation practices in structured finance, and, more generally, from operating an "issuers pay" business model instead of "investors pay" models.[160] In addition, many failed to adjust their ratings in time in order to reflect the worsening market conditions leading up to the crisis.[161]

Against this background, in September 2009, a directly applicable *Regulation on credit rating agencies* was enacted,[162] taking account of the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of

159 See COM (2010) 301 final, at 8, 10, online: <http://ec.europa.eu/internal_market/finances/docs/general/com2010_en.pdf>.

160 Elisabetta Cervone, "Regulating Credit Rating Agencies in a Transatlantic Dialogue" (2008) European Business Law Review 821 at 833 et seq.

161 See *Regulation* (EC) No. 1060/2009 of 16/9/2009 on credit rating agencies, recital 1 and 10; see also Thomas M. J. Möllers, "Credit Rating Agencies under New US and EU Law — Important Steps or Much Ado about Nothing?" (2009) 4 Common Market Law Journal 477; Marco Lamandini, "Credit Rating Agencies (CRAs) and European Regulation" (2009) European Company Law 131.

162 *Regulation* (EC) No. 1060/2009, supra, n. 161. For an overview of preparatory works see online <http://ec.europa.eu/internal_market/securities/agencies/index_en.htm>. See also Fabian Amtenbrink & Jakob De Haan, "Regulating credit ratings in the European Union: A critical first assessment of Regulation 1060/2009 on credit rating agencies" (2009) Common Market Law Review 1915; Marcus P. Lerch, "Ratingagenturen im Visier des europäischen Gesetzgebers" (2010) Zeitschrift für Bank- und Kapitalmarktrecht 402; Gudula Deipenbrock, "Das europäische Modell einer Regulierung von Ratingagenturen — aktuelle praxisrelevante Rechtsfragen und Entwicklungen" (2010) Recht der internationalen Wirtschaft 612.

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Securities Commissions (IO-SCO)[163] and the second CESR report on the role of credit agencies in structured finance.[164]

(i) Issuers of Credit Ratings Used for Regulatory Purposes

The *Regulation* applies to credit ratings (*i.e.*, an opinion regarding the creditworthiness of an entity, of a financial instrument, or of an issuer of such instrument, using an established and defined ranking system of rating categories) issued by an agency registered in the EU, if such ratings are disclosed publicly or distributed by subscription.[165] In addition, Article 14 requires the registration of any agency established in the EU that issues such credit ratings (European credit rating agency).[166] Finally, Article 4(1) stipulates that the financial institutions listed therein may use credit ratings for regulatory purposes only if they are issued by such a European credit rating agency.

Since registration pursuant to Article 14 is limited to European credit rating agencies and subsidiaries (*i.e.*, separate legal entities) established in EU Member States of agencies domiciled outside the EU,[167] the *Regulation* provides for different mechanisms allowing the use of ratings issued by agencies established in third countries for regulatory purposes as defined in Article 4(1). First, a European credit rating agency may endorse credit ratings issued by third-country agencies if, subject to a set of further formal conditions, such an agency and its credit rating activities leading to the issue of credit ratings comply with supervisory requirements which are at least equivalent to those laid down under Articles 6 to 12.[168] Moreover, Article 5(1) provides for credit ratings relating to third-country entities or financial instruments to be used for regulatory purposes pursuant to Article 4(1), if such ratings are issued by third-country agencies that are certified pursuant to Article 5.[169]

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163 Available online: <http://www.iosco.org/>. *Regulations*, as opposed to *Directives*, are directly applicable in EU Member States alongside national laws without prior implementation, see *supra*, part 2(c).

164 Online: <http://www.cesr-eu.org/popup2.php?id=5049>.

165 Art. 2(1) of the *Regulation*. "Credit ratings" are defined under Art. 3(1)(a).

166 Art. 14(1) of the *Regulation*, *supra*, n. 161.

167 Fabian Amtenbrink & Jakob De Haan, "Regulating credit ratings in the European Union: A critical first assessment of Regulation 1060/2009 on credit rating agencies", *supra*, n. 162 at 1930.

168 Art. 4(3) and recital 13 of the *Regulation*. The Commission mandated CESR to provide technical advice on the equivalence between the EU and other countries' regulatory and supervisory regime for credit rating agencies. So far, CESR provided such Technical Advice with respect to the U.S. and the Japanese regime, considering both as equivalent; available online: <http://www.esma.europa.eu/index.php?page=contenu_groups&id=43&docmore=1>.

169 This specific "equivalence and certification procedure" is designed for smaller third-country agencies that are affiliated or work closely with agencies established in the EU; for details see recitals 14/15 and Art. 5 of the *Regulation*.

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(ii) "External Credit Assessment Institutions" under the Capital Requirements Directive

As an important exception to Article 4(1), the *Regulation* does not fully determine whether credit ratings may be used for the purpose of determining credit quality as part of assessing risk weight under the CRD. This follows from Article 2(3) stipulating that a credit rating agency will be required under this *Regulation* as a condition for being recognized as an External Credit Assessment Institution (ECAI) under *Directive* 2006/48/EC, and from Recital 44 of said *Regulation* clarifying that this *Regulation* does not replace the established process of recognizing ECAIs under the said *Directive*. In other words, the *Regulation* imposes an additional requirement for credit rating agencies to be recognized as ECAIs alongside the requirements set down in Part 2 of Annex VI to Directive 2006/48/EC of being registered under the *Regulation*. From the viewpoint of third-country credit rating agencies certified in accordance with Article 5(1), this begs the question whether they fulfill the additional requirement established by Article 2(3). The wording ("registration") clearly points to the negative. However, given that Article 5(1) puts certification on almost the same footing as registration with regards to the eligibility of credit ratings for regulatory purposes, it is submitted here that Article 2(3) should be read as "registration or certification".

(iii) Key Substantive Requirements

The key requirements that agencies have to comply with are laid down in Article 6. In particular, they are to be independent and implement a variety of mechanisms to avoid (or at least disclose) any conflict of interests in their employees' activity.[170] For instance, if structured finance instruments are to be rated, agencies must ensure that analysts or persons who approve ratings do not make proposals or recommendations regarding the design of these instruments,[171] nor carry out any similar consultancy or advisory services.[172]

Even beyond that, instruments of structured finance are dealt with rather strictly. When an agency issues respective credit ratings, it will have to ensure that rating categories which are attributed to such products are clearly differentiated, using an additional symbol which distinguishes them from rating categories used for any other entities or assets.[173]

Finally, to ensure the quality and transparency of credit ratings, the *Regulation* stipulates a set of provisions concerning, for example, the procurement and processing of information and the ongoing review with respect to changes in market conditions. In addition, agencies are to use rating methodologies that are rigorous, systematic, continuous and subject to validation based on historical experi-

170 See also Annex I, Section A of the *Regulation*, *supra*, n. 161.

171 Annex I, Section B, para. 5 of the *Regulation*, *supra*, n. 161.

172 See recital 22 and Art. 7 of the Regulation, supra, n. 161.

173 Art. 10(3) of the *Regulation*, *supra*, n. 161. See also Annex I, Section D, II, which stipulates a variety of stringent additional obligations in relation to credit ratings of structured finance instruments.

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ence, including back-testing.[174] These methodologies, just like models and key rating assumptions used in rating activities, are also to be disclosed to the public.[175]

Registrations are currently issued by the national supervisory authorities of Member States upon formal application, which must initially be submitted to the CESR.[176] Member States are also responsible for the ongoing supervision of the agencies. If necessary, the authorities are competent to withdraw registrations, temporarily prohibit the issue of credit ratings or suspend the use of such ratings, take appropriate measures to ensure compliance with legal requirements, issue public notices or initiate criminal prosecution proceedings.[177]

In June 2010, the Commission adopted a proposal to amend this existing *Regulation* on credit rating agencies.[178] Under the new concept, the supervision of agencies would be more centralized and concentrated at the ESMA,[179] including the conferral of special powers to impose fines, request information, launch investigations and perform on-site inspections.[180] Only a few specific supervisory powers related to the use of credit ratings would remain in the remit of national authorities, thereby reflecting the internationalized business specificities of the credit rating market.[181] In addition, registered or certified rating agencies are to be given a right to access a list of structured finance instruments that are being rated by their competitors, resulting in the issuance of unsolicited extra ratings which are expected to enhance competition on the market, help avoid conflicts of interests and enhance the quality and transparency of ratings for such instruments.[182]

The Commission's proposal is currently being passed on to the Council and Parliament and is expected to come into force by the end of 2011. In addition, on May 21, 2010, the CESR published technical advice in relation to the equivalence between the U.S. legal and supervisory framework and the EU regulatory regime.[183]

(b) Alternative Investment Funds

EU regulation of the funds industry has traditionally been limited to investment funds (Undertakings for Investments in Transferable Securities —

174 Art. 8(2) and (3) of the *Regulation*, *supra*, n. 161.

175 Art. 8(1) of the *Regulation*, *supra*, n. 161.

176 Art. 14 *et seq*. of the *Regulation*, *supra*, n. 161.

177 Art. 24 of the *Regulation*, *supra*, n. 161.

178 COM (2010) 289 final of 2/6/2010, online: <http://ec.europa.eu/internal_market/securities/agencies/index_en.htm>.

179 As to the general concept behind establishing the ESMA see *supra*, at part 4(a).

180 For instructions see at 5 *et seq*. of COM (2010) 289 final, *supra*, n. 178.

181 See the Commission's impact assessment of 2/6/2010, available online: <http://www.esma.europa.eu/popup2.pho?id=6642>.

182 See recital 5 and new Art. 8a at 15/16 of COM (2010) 289 final, *supra*, n. 178.

183 Available online: <http://www.esma.europa.eu/popup2.php?id=6642>.

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UCITS).[184] All other funds, such as hedge funds,[185] private equity funds, commodity funds, real estate funds and infrastructure funds are at the moment still regulated primarily by the respective laws of EU Member States, sometimes supplemented by certain industry-developed standards.

Widespread demand for a European regulation of such alternative investment funds (AIFs) resulted primarily from activities of hedge funds and private equity funds known as shareholder activism[186] and also out of concern for the systemic risks associated with some hedge funds because of their high leverage.[187] The Commission presented an initial proposal for a *Directive* on AIF managers (AIFM)[188] in April 2009, shortly before the Commission's and, hence, Commissioner McCreevy's term of office ended.[189] It was followed by a long and increasingly fractious debate among EU institutions, Member States and various lobby groups,[190] until a legislative compromise — cutting through the Gordian knot which resulted from disagreement over the treatment of offshore funds domiciled outside the European Union[191] — was finally reached in October 2010.[192] It must now be implemented into national law by early 2013.

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184 *Supra*, n. 47 and accompanying text.

185 See Lucia Quaglia, "The 'old' and 'new' political economy of hedge fund regulation in the EU" (2009), online: <http://www.uaces.org/pdf/papers/0901/quaglia.pdf>.

186 See *e.g.*, the European Parliament's Committee on Economic and Monetary Affairs, "The Economic Consequences of Large Shareholder Activism", study of 15/7/2009, available online: <http://www.eubusiness.com/topics/europarl/aggregator/ema-committee>; see also Parliament's 2008 report on hedge funds and private equity, online: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+REPORT+A6-2008-0338+0+DOC+XML+V0//EN>.

187 See *e.g.*, the final *Larosière* report, *supra*, n. 62 at 23–25.

188 COM (2009) 207 final of 30/4/2009, online: <http://ec.europa.eu/internal_market/investment/docs/alternative_investments/fund_managers_proposal_en.pdf>; as to this initial proposal see Ulf Klebeck, "Neue Richtlinie für Verwalter von alternativen Investmentfonds?" (2009) Deutsches Steuerrecht 2154.

189 Commissioner McCreevy's opposition to hedge fund regulation was well-known prior to the crisis, so the proposal documented a rather sharp change in position; see Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2276.

190 For an overview see Friedrich Kübler, "Taming the Monsters?", in: Stefan Grundmann, Brigitte Haar, Hanno Merkt *et al.*, (ed.), *Festschrift für Klaus J. Hopt* (Berlin/New York: de Gruyter, 2010) 2143 at 2147 et seq.

191 See in more detail *infra*, part 6(b)(iv). This controversial issue even evoked a remarkable outcry at the international level. In particular, in a March 2010 letter to the European Commission, U.S. Treasury Secretary *Timothy F. Geithner* raised strong concerns over the draft *Directive's* alleged risk of discriminating against U.S. funds, see online: <http://www.euractiv.com/en/financial-services/eu-rejects-us-claims-hedge-funds-regulation-rift-news-330649>.

192 The agreed text is available online: <http://register.consilium.europa.eu/pdf/en/10/st15/st15053-re01.en10.pdf>.

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(i) Authorization and Supervisory Regime

The new *Directive* introduces a legally binding authorization and supervisory regime for all AIFMs operating within the EU. Respective powers, including sanctions,[193] will be entrusted predominantly to the Member States' supervisory authorities, but the ESMA will support and coordinate such authorities to promote regulatory convergence.[194] Most of the *Directive's* extensively detailed provisions are designed to apply irrespectively of the legal domicile of the AIF managed, provided that the portfolio(s) managed exceed a threshold of € 100 million or — in cases of AIFMs which only manage unleveraged AIFs and do not grant investors redemption rights during a period of five years — of € 500 million in total assets.[195] U.S. and other offshore AIFMs aspiring to EU market access will therefore be captured by the *Directive* as well.[196]

With respect to supervision, all AIFMs will be required to satisfy the authorities of their management qualification, the robustness of their internal risk management (including adequate remuneration policies[197]) and the availability of sufficient initial and ongoing capital.[198] They must provide detailed information on, *inter alia*, their investment strategies, the identity and characteristics of the AIFs managed, the arrangements for the valuation and safe-keeping of assets and the disclosure of conflicts of interests.[199] In order to support effective macro-prudential oversight of their activities, AIFMs will also be required to report to the authorities on a regular basis on the principal markets and instruments in which they trade, their principal exposures, performance data and concentrations of risks.[200]

AIFMs must also ensure that an independent depositary is appointed for each fund they manage in order to fulfill a variety of organizational tasks, such as to receive all payments made by investors and to safe keep any financial instruments which belong to the respective AIF.[201] In many cases the depositary will be an EU

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193 See Art. 46 and recital 47 of the *Directive*, *supra*, n. 192.

194 For this purpose, the *Directive* entrusts the ESMA with no less than 72 different tasks, including the development of technical standards and guidelines in various areas, supervisory functions, intervention on the basis of emergency powers, dispute resolution between national authorities, review assessment, and direct imposition of sanctions on parties under certain circumstances; see, for instance, recital 46 of the *Directive*, *supra*, n. 192.

195 Recital 13 and Art. 3(2) of the *Directive*, *supra*, n. 192; see also Friedrich Kübler, "Taming the Monsters?", *supra*, n. 190 at 2145.

196 See in greater detail *infra*, at part 6(b)(iv). For critical remarks on the extra-territorial application of EU law in general and the AIFM *Directive* in particular see Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2278.

197 Art. 13 and Annex II of the *Directive*, *supra*, n. 192.

198 Arts. 6 *et seq*. of the *Directive*, *supra*, n. 192. For instance, an AIFM must provide own funds of at least € 125,000 plus 0.02 percent of the amount by which the value of the portfolios of the AIFM exceeds € 250 million, see in detail Art. 9 of the *Directive*.

199 See Arts. 7(2) and (3), 14, 19 of the *Directive*, *supra*, n. 192.

200 Art. 24 of the *Directive*, *supra*, n. 192.

201 Recitals 25 *et seq*. and Art. 21 of the *Directive*, *supra*, n. 192.

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credit institution authorized and registered in accordance with the CRD, but it may also be an investment firm or another entity permitted under the UCITS *Directive*.[202] For non-European funds exclusively, non-EU credit institutions or other entities may perform depositary functions, provided that such entities are subject to equivalent prudential regulation and supervision in their state of origin.[203] Depositaries will be liable to AIFMs and investors for any breach of their new obligations.[204] In addition, an independent third party valuator must be appointed to valuate the fund's assets, shares and units at least once a year.[205]

The *Directive* stipulates a considerable level of service and information to be provided for investors in order to facilitate due diligence and ensure appropriate investor protection. In particular, AIFMs must provide their investors with a clear description of their investment and redemption policy in normal and exceptional circumstances, applicable valuation, custody, administration and risk management procedures, as well as the fees, charges and expenses associated with an investment.[206]

Subject to prior notification to the authorities and a variety of substantive conditions, AIFMs may delegate one or more of their functions to third parties.[207] In this case, AIFMs must review the services provided by said third party on an ongoing basis and assume full liability for potential misconduct on their behalf. Within certain bounds, the third party may sub-delegate any of the functions delegated to it.[208]

(ii) Additional Requirements for Leveraged Funds and Private Equity Funds

Additional specific requirements are envisaged for AIFMs managing leveraged AIFs[209] and AIFMs acquiring major stakes in non-listed private companies.[210] For instance, national authorities will under certain circumstances be empowered to impose leverage restrictions and limitations,[211] and AIFMs employing leverage on a substantial basis above a certain threshold yet to be defined by the Commission will be subject to far-reaching disclosure requirements by their home state authority.[212]

With respect to a portfolio company in which an AIFM has acquired a control-

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202 Recital 24 and Art. 21(3) of the *Directive*, *supra*, n. 192.

203 *Ibid.* This opening accommodates the fact that the international depositary business for funds is currently dominated by large non-EU-bank undertakings.

204 Recital 30 and Art. 21(11) and (12) of the *Directive*, *supra*, n. 192.

205 Art. 19 of the *Directive*, *supra*, n. 192.

206 Art. 23 of the *Directive*, *supra*, n. 192.

207 Art. 20 of the *Directive*, *supra*, n. 192.

208 Art. 20(3) of the *Directive*, *supra*, n. 192.

209 Art. 25 and recital 33 of the *Directive*, *supra*, n. 192; see also Friedrich Kübler, "Taming the Monsters?", *supra*, n. 190 at 2146.

210 Arts. 26 *et seq.* of the *Directive*, *supra*, n. 192.

211 Art. 25(3) of the *Directive*, *supra*, n. 192.

212 Art. 24(4) and recital 33 of the *Directive*, *supra*, n. 192.

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ling interest,[213] the *Directive* arranges for the disclosure of relevant information to the company concerned — whose board of directors is to be requested by the AIFM to pass on the information to the employees — fellow shareholders and national authorities.[214] Such information will include, *inter alia*, the AIFM's intentions with regard to the future business of the company, its policies to prevent conflicts of interest and details on the financing of the acquisition.[215] In addition, specific (annual) reporting obligations are designed to admonish private equity and buy-out funds to account publicly for the manner in which they manage companies of wider public interest.[216] The *Directive* also protects newly acquired private companies from so-called recapitalization transactions, by a set of rules grouped under the biassed heading "asset stripping". For instance, AIFM will not be allowed to facilitate, support or instruct any distribution, capital reduction, share redemption or acquisition of own shares by the acquired company within two years following the acquisition.[217] Finally, AIFMs will be subject to an obligation to notify the competent authorities of the acquisition and disposal of so-called "major holdings" in private companies, *i.e.*, if the proportion of voting rights reaches, exceeds or falls below certain thresholds.[218] The increased bureaucratic workload and the restrictions resulting from these provisions drew sharp criticism from large parts of the private equity industry, given that strategic investors and corporate acquirers other than funds will not be subject to these requirements and hence put at a competitive advantage.

(iii) European Passport for EU Entities

As a corollary of the high regulatory standard achieved by the new *Directive*, AIFMs authorized in one EU Member State will be entitled to market their funds to investors in the territory of any Member State — albeit only to professional investors and subject to prior notification to the host state authorities[219] (so-called "European passport"). Member States will not be permitted to impose any additional

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213 A general definition of "control" is provided under Art. 4(1)(j) of the *Directive*. In essence, it covers the ability to exercise 30% or more of the voting rights in the respective company. With respect to the acquisition of interest in non-listed companies, however, "control" means more than 50% of the voting rights, see Art. 26(5) of the *Directive*, *supra*, n. 192.

214 Art. 28(1) and (2) of the *Directive*, *supra*, n. 192.

215 Art. 28(3) and (4), recitals 34 and 35 of the *Directive*, *supra*, n. 192.

216 Art. 29 of the *Directive*, *supra*, n. 192. However, the *Directive* does not extend these requirements to the acquisition of control in small and medium sized enterprises, thereby seeking not to impede start-up or venture capital providers; see Art. 26(2)(i) of the *Directive*.

217 Art. 30, recitals 36 and 37 of the *Directive*, *supra*, n. 192.

218 Art. 27(1) of the *Directive*, *supra*, n. 192. The pertinent thresholds are 10%, 20%, 30%, 50% and 75%.

219 Art. 31 *et seq*. of the *Directive*, *supra*, n. 192. "Marketing" means any direct or indirect offering or placement of units or shares at the initiative or on behalf of the AIFM, *i.e.*, "reverse inquiries" at an investor's initiative are not subject to the *Directive's* authorization regime.

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requirements. The marketing of AIFs to retail investors, on the other hand, remains a matter of national law. If Member States decide to generally allow such retail marketing, however, they may not discriminate against cross-border deals by imposing stricter or additional requirements on funds established in another Member State (*i.e.*, funds marketed on a cross-border basis) than on funds established domestically.[220]

(iv) European Passport for Non-EU Entities

The controversial and highly politicized debate on the treatment of offshore funds and fund managers resulted in granting such funds and managers a form of "European passport" as well. Unfortunately, the details of the *Directive* are much more complex than this promising *prima facie* assessment would suggest. Most notably, the new passport regime will actually take effect only after a transitional period of two more years.[221] During this period, the regime will be fleshed out by delegated acts yet to be adopted by the Commission.[222] Given that the *Directive* is due for implementation into national law by early 2013, EU passports will not be available until 2015. On top of that, the transition period will be followed by a three-year period, during which the new passport arrangements will coexist with national private placement rules subject to certain minimum harmonized conditions.[223] As a consequence, the *Directive's* EU passport mechanism will not become the only venue for access to EU Member States markets until 2018, when national regimes are expected to be terminated after a coordinated review by the ESMA and the Commission.[224]

With regard to the substance and content of the new passport regime, a first crucial distinction must be made between authorized European AIFMs' rights to manage and market non-EU AIFs on the one hand, and non-EU AIFMs' rights to manage and market funds in the EU on the other.

Authorized European AIFMs will be entitled to manage non-EU AIFs, subject to compliance with most substantive requirements of the *Directive* (excluding those concerning depositaries and annual reports under Articles 21 and 22) and the existence of appropriate cooperation arrangements between the authorities of the respective AIFM's home EU Member State and the authorities of the fund's country of origin.[225] Similarly, EU fund managers will be entitled to market non-EU AIFs within the EU, albeit only to professional investors,[226] and subject to certain notification procedures and the existence of a qualified tax agreement between the respective states involved;[227] this appears necessary in order to tax domestic professional investors investing in offshore funds. In addition, the respective third country

220 See Art. 41 and recital 45 of the *Directive*, *supra*, n. 192.

221 See the concise description in recital 4 of the *Directive*, *supra*, n. 192.

222 Recital 49 of the *Directive*, *supra*, n. 192.

223 Recital 4 of the *Directive*, *supra*, n. 192.

224 See recitals 4, 41, 49, 53, Art. 63ter of the *Directive*, *supra*, n. 192.

225 Art. 34 of the *Directive*, *supra*, n. 192.

226 Once again, marketing to retail investors remains a matter of national law.

227 Art. 35 of the *Directive*, *supra*, n. 192.

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may not be listed as a Non-Cooperative Country and Territory by the Financial Action Task Force on anti-money laundering and terrorist financing (FATF).[228]

Non-European fund managers intending to operate within the EU must acquire prior authorization, which will be predicated on full compliance with the terms of the Directive[229] (in particular the transparency and capital requirements and the appointment of an independent valuer and a depositary). On this basis they may market within all EU Member States both EU and non-EU funds which they manage, albeit subject to a set of mostly procedural preconditions.[230] The new *Directive* takes a rather liberal approach to third-country issues, which sharply contrasts with earlier drafts that had provided for a variety of additional, rather onerous preconditions for obtaining a "European passport", which had required the reciprocal granting of market access for EU entities by the respective fund's or fund manager's home country, and the home country's regulatory standard to be deemed at least equivalent to EU standards.[231]

Finally, the so-called "Member State of reference" is tasked with authorizing third-country entities to operate in the EU and with supervising compliance with the *Directive*.[232] If EU funds are to be marketed, the respective fund's country of origin will be the Member State responsible. The situation is less clear for non-EU AIFs; with respect to those entities, it will probably depend on with which Member State the proposed marketing activities are most closely associated. It remains to be seen whether this new regulatory structure — as some skeptics suspect — will indeed present significant practical challenges due to the various difficulties of cross-border supervision and cooperation.

(c) OTC Derivatives and Market Infrastructures

Another part of the EU's crisis-driven efforts to tighten the grip on securities regulation is the September 2010 Commission proposal for a *Regulation* on over-the-counter (OTC) derivatives and uniform requirements for the performance and activities of central counterparties and trade repositories.[233] Inspired by the G20 leaders' agreements issued at the summits in Pittsburgh[234] (September 2009) and Toronto[235] (June 2010), which highlighted that all standard OTC derivative contracts should be traded on exchanges or electronic trading platforms — when ap-

228 See Art. 35(2)(b) of the *Directive*, *supra*, n. 192.

229 Art. 37(1) and (2) of the *Directive*, *supra*, n. 192.

230 See Arts. 38 *et seq*. of the *Directive*, *supra*, n. 192.

231 See, for instance, Art. 39 of the initial Commission proposal, *supra*, n. 188.

232 This state will be determined following a complicated procedure under Art. 37(4) to (6) of the *Directive*, *supra*, n. 192.

233 COM (2010) 484/5 of 15/9/2010, available online: <http://ec.europa.eu/internal_market/financial-markets/derivatives/index_en.htm>. For background analysis on the inner workings of OTC markets see Daniel Marcus & Liévin Tshikali, "Some misconceptions about OTC markets" (2010) Law and Financial Markets Review 263; see also Michael Nietsch & Andreas Graef, "Regulierung der europäischen Märkte für auβerbörsliche OTC-Derivate" (2010) Betriebs-Berater 1361.

234 Online: <http://www.pittsburghsummit.gov/documents/organization/129853.pdf>, at 9.

235 Online: <http://www.g20.utoronto.ca/2010/g20_declaration_en.pdf> at para. 25.

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propriate — and cleared through central counterparties by end-2012, the Commission now intends to increase transparency, reduce counterparty and operational risks in trading, enhance market integrity and improve prudential supervision on the basis of mandatory rules.[236] Earlier self-regulatory approaches in this area, *i.e.*, incentives to promote the voluntary use of central counterparties, have not proven to be sufficient.[237]

Consequently, Article 3 of the proposal introduces a cornerstone obligation to clear all eligible classes of standardized OTC derivative contracts through central counterparties (CCPs).[238] This will primarily apply to "financial counterparties", *e.g.*, investment firms, credit institutions, insurance and UCITS undertakings, or AIFM. Other companies ("non-financial counterparties") will only be subject to the clearing obligation if they take systemically important positions in derivatives above a certain threshold yet to be determined by the Commission and the ESMA.[239] By contrast, insofar as such companies' derivatives positions are deemed to merely cover against commercial risks directly linked to their commercial activity, the *Regulation* will not apply.[240] For the purpose of compliance, counterparties are required to gain access to clearing services either by direct participation in a CCP as a clearing member or by entering into a client relationship with a clearing member already established.[241] The ESMA will decide whether a class of derivatives meets the eligibility criteria, that is, whether and when the clearing obligation will actually take effect. Insofar the proposal allows for two different ways of determination: a "bottom-up" approach,[242] designed to reflect the actual clearing practice already adopted by established CCPs, and a more autono-

236 The identification of complex interdependences and systemic risks associated with this segment seems inevitable to prevent uncertainty in times of market stress, given that information about derivatives as privately negotiated contracts is rather obscure and, by its very nature, in most cases only available to the contracting parties.

237 Recital 9 of the proposal; see also Niamh Moloney, "The Financial Crisis and EU Securities Law-Making: A Challenge Met?", *supra*, n. 18 at 2275. For a more in-depth evaluation of self-regulatory approaches see Julia Black, "Decentering Regulation: Understanding the Role of Regulation and Self Regulation in a 'Post Regulatory World'" (2001) 54 Current Legal Problems 103.

238 A central counterparty is an entity that legally interposes itself between the counterparties to the contracts, thereby becoming the buyer to every seller and the seller to every buyer, and which is responsible for the operation of a clearing system (multilateral netting); see Art. 2(1) of the proposal and Uwe Jahn, "Die Finanzkrise und ihre rechtlichen Auswirkungen auf Rahmenverträge über OTC-Derivategeschäfte" (2009) Zeitschrift für Bank- und Kapitalmarktrecht 25 at 27 *et seq.*

239 Art. 7(2)–(5) of the proposal.

240 See page 7 and recital 16 of the proposal. This may be the case for energy suppliers that sell future production, agricultural firms fixing the price at which they are going to sell their crops, airlines fixing the price of their future fuel purchases or any other commercial companies that must legitimately hedge the risk arising from their specific activity.

241 Art. 3(2) and recital 19 of the proposal, *supra*, n. 233.

242 See Art. 4(1)–(4) and at 6 of the proposal, *supra*, n. 233.

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mous "top-down" approach,[243] to identify eligible contracts in the market which are not yet being cleared.

As regards derivatives which are exempted from central clearing and will thus continue to be managed on a bilateral basis — either because they do not satisfy the eligibility criteria or because relevant thresholds are not exceeded — the proposal strives for maximum risk mitigation and requires, *inter alia*, the use of certain electronic means and the existence of management procedures with timely, accurate and appropriately segregated exchange of collateral supported by an appropriate and proportionate holding of capital.[244] As a consequence, even if the clearing obligation does not apply, trading in OTC derivatives is likely to become less profitable for credit institutions and other relevant market participants.

In addition, Article 6 stipulates an obligation to report, within one working day, the details of any OTC derivative contract entered into — irrespective of whether central clearing takes place — and to report any modification or termination of such contracts to a trade repository, *i.e.*, an entity that centrally collects and maintains the records of relevant transactions.[245] This requirement will apply to all financial counterparties, whilst non-financial counterparties will be required to notify and provide justification to the competent authority for taking those positions, if such positions exceed yet another threshold of significant positions.[246] The Commission will determine the details, type, format and frequency of these reports, following technical standards to be developed by the ESMA.[247] Consequently, transparent information on market risks will be centrally stored and easily accessible to the ESMA, central banks and other authorities.[248]

As regards enforcement, Article 9 of the proposal obliges Member States to develop and apply rules on effective, proportionate and dissuasive penalties for infringements of the clearing and reporting obligations, including administrative fines.

The most detailed part of the proposal, however, concentrates on the authorization, supervision and internal organization of CCPs.[249] All CCPs established in the EU — no matter if already practicing for years or entirely new to the market — will require authorization by national supervisors, which will also remain responsible for day-to-day supervision,[250] albeit supported by a network of well-organized pan-European cooperation.[251] This is considered an essential corollary to the proposal's key concern of having all OTC derivatives cleared[252] and enjoins stringent capital and liquidity requirements for CCPs, including a mandatory initial capital of

243 Art. 4(5) and at 6 of the proposal, *supra*, n. 233.
244 Art. 8, at 8 and recital 14 of the proposal, *supra*, n. 233.
245 For this definition see Art. 2(2) of the proposal, *supra*, n. 233.
246 See Arts. 6 and 7(1) of the proposal, *supra*, n. 233.
247 Art. 6(4) of the proposal, *supra*, n. 233.
248 Recital 22 of the proposal, *supra*, n. 233.
249 Arts. 10–46, recitals 26 *et seq*. of the proposal, *supra*, n. 233.
250 Art. 18 of the proposal, *supra*, n. 233.
251 Art. 19 *et seq*. and recital 31 of the proposal, *supra*, n. 233.
252 Recital 29 and at 9 of the proposal, *supra*, n. 233.

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at least € 5 million.[253] The authorization process, in which the ESMA and an international college of supervisors[254] are involved, is rather intricate, and will also apply if an already authorized CCP merely wishes to extend its business to additional services or activities.[255] Any authorization will be effective for the entire EU territory.[256]

Ambitious organizational requirements for CCPs address, *inter alia*, the independence of board members, the establishment of risk committees, record keeping, conflicts of interest, investment policies, outsourcing of operational functions, services or activities, disclosure of governance arrangements, and independent audits.[257] Since, according to the Commission, the failure of a CCP would in almost all cases become a potential systemic event for the financial system, CCPs will be required to mitigate their counterparty credit risk exposure through a number of strict reinforcing mechanisms. These include procedures to handle the default of clearing members[258] (including default funds[259]), stringent but non-discriminatory[260] participation requirements[261] and adequate segregation and portability of positions and corresponding collateral.[262] In addition, interoperability arrangements between two or more CCPs will be subject to adequate risk management and prior approval of competent authorities.[263]

Regarding CCPs from non-EU countries seeking to provide clearing services within the EU, the ESMA will be directly responsible for the recognition and licensing process. Market admittance will be granted if the Commission has ascertained the legal and supervisory framework of the respective non-EU country as being equivalent to the EU's requirements, namely if actual authorization and prudential supervision of that CCP is guaranteed and if cooperation arrangements between the ESMA and the non-EU country authorities are in place.[264] Given the global nature and importance of clearing services, however, it has been criticized that the recognition of non-EU CCPs is not made conditional on reciprocity, *i.e.*, on the recognition and admittance of European CCPs by the respective third country. Furthermore, the licensing process for non-EU CCPs is said to appear less complex and laborious than the authorization procedure for European entities.

253 Art. 12(1) of the proposal, *supra*, n. 233.

254 Arts. 13 *et seq*. of the proposal, *supra*, n. 233.

255 Art. 11(1) of the proposal, *supra*, n. 233.

256 Art. 10(2) of the proposal, *supra*, n. 233.

257 See Arts. 24 *et seq*., at 9/10 of the proposal, *supra*, n. 233.

258 Art. 45 of the proposal, *supra*, n. 233.

259 Art. 40 of the proposal, *supra*, n. 233.

260 As to specific concerns regarding potential discriminatory business practice, *e.g.*, with respect to anti-competitive behaviour of clearing houses owned by exchanges ("vertical silo"), see recital 20 of the proposal, *supra*, n. 233.

261 Art. 35 of the proposal, *supra*, n. 233.

262 Art. 37, at 10 of the proposal, *supra*, n. 233.

263 Arts. 49 and 50, recitals 40 *et seq*. and at 11 of the proposal, *supra*, n. 233.

264 Art. 23, recital 32 and at 9 of the proposal, *supra*, n. 233.

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Finally, trade repositories, too, will be required to register with the ESMA[265] and to submit themselves to rather strict ongoing surveillance by the ESMA. They need to comply with a detailed canon of supervisory standards and obligations[266] and may face investigations (including on-site-inspections) and severe fines or penalty payments upon infringement.[267] The main regulatory objective behind this approach is to ensure that systemically important information maintained by trade repositories is at all times reliable, secured and well protected.[268] However, the future regulatory importance of trade repositories probably will entail a variety of business opportunities for providers of market infrastructures, although profit margins will probably be rather modest as "the prices and fees charged by a trade repository shall be cost-related".[269] In contrast to this sanguine perception, some voices have advocated the development of only one global trade repository for each asset class because the development of separate regional trade repositories is thought to cause a fragmentation of information, to increase operational costs and to add to the risk of duplicative or omitted reporting of transaction information.[270]

Notwithstanding the Commission proposal's dedication to detailed and sophisticated regulatory intervention, it does not address — except for in its short explanatory memorandum — one of the key objectives repeatedly highlighted by the G20 leaders, namely that derivative contracts should, wherever possible, be traded on exchanges or electronic trading platforms. Put differently, the proposal does not require standardization of OTC contracts and does not even provide for rules that promote such product standardization, probably due to the inherent difficulties in and "natural" limits to any such attempts.[271]

(d) Short Selling and Credit Default Swaps

The Commission's proposal for a *Regulation* on short selling and certain aspects of credit default swaps (CDS) of September 15, 2010[272] was preceded by a public consultation[273] and a set of CESR publications.[274]

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265 Arts. 51 *et seq*. of the proposal, *supra*, n. 233.

266 Arts. 64 *et seq*. of the proposal, *supra*, n. 233.

267 See Arts. 55/56 and recitals 46 *et seq*. of the proposal, *supra*, n. 233.

268 See recitals 43 *et seq*. and at 11 of the proposal, *supra*, n. 233.

269 Art. 64(6) of the proposal, *supra*, n. 233.

270 See Association for Financial Markets in Europe (AFME), "Prevention and Cure: Securing Financial Stability After the Crisis" (September 2010) at 24/25, available online: <http://www.afme.eu/>.

271 See *inter alia*, Zentraler Kreditausschuss (ZKA), Response to the Consultation of the European Commission on possible initiatives to enhance resilience of OTC derivatives markets, of 31/8/2009, available online: <http://www.bankenverband.de/downloads/082009/sp0908-re-otc-derivatemaerkte.pdf>, at 3 *et seq*.

272 COM (2010) 482 of 15/9/2010, online: <http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_proposal_en.pdf>.

273 The consultation document is available online: <http://ec.europa.eu/internal_market/consultations/2010/short_selling_en.htm>.

274 CESR, "Model for a Pan-European Short Selling Disclosure Regime" of 2/3/2010 (CESR/10-088) and "Technical details of the Pan-European Short Selling Disclosure

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In substance, the Commission is of the opinion that in some situations short selling practices are applied in an abusive fashion, *e.g.*, to intentionally drive down the price of an asset, and thus may be a contributory cause of disorderly, instable financial markets. In addition, as regards uncovered ("naked") short sales, there might be an increased risk of settlement failures and price volatility.[275] Finally, given that in September 2008, several Member States adopted divergent unilateral measures to restrict or to ban short selling strategies in some or even all assets. The Commission holds that a harmonized regime for short selling issues is needed to increase the resilience and stability of financial markets in the EU. This regime includes rules to increase the transparency related to short sales in general, rules to reduce risks of uncovered short sales, and the introduction of restrictions on certain short selling practices under particular circumstances.

Most importantly, short sales with respect to shares listed on regulated trading venues (*i.e.*, stock markets) will generally be prohibited unless the seller has either actually borrowed that share, entered into an agreement to do so, or has evidence of other arrangements which ensure that he or she will be able to borrow the shares at the time of settlement. Naked short sales of listed shares will come to an end.[276] Restrictive exemptions may apply if the principal trading venue of respective shares is located outside the EU,[277] and for certain market making activities.[278] Moreover, competent national authorities[279] will receive emergency powers to impose temporary restrictions on short selling of financial instruments — whether traded on or outside trading venues — in exceptional situations, subject to prior notification to and coordination by the ESMA.[280] Such "exceptional situations" include "adverse events or developments which constitute a serious threat to financial stability or to market confidence"[281] — in which case the restriction must not exceed three months, but can be renewed[282] — or a significant fall in price of a financial instrument on a trading venue during one single trading day,[283] which will justify a measure for a period not exceeding the next trading day.[284] In line with the new ESFS principles and general supervisory architecture,[285] the ESMA itself may

Regime" (CESR/10-453) of 26/5/2010, both available online: <http://www.esma.europa.eu/index.php?page=contenu_groups&id=22&docmore=1>.

275 See in particular, recitals 1 and 16 of the consultation document, *supra*, n. 273.

276 See Art. 12 of the proposal, *supra*, n. 272.

277 Art. 14 and at 8 of the proposal, *supra*, n. 272.

278 Art. 15 and at 8/9 of the proposal, *supra*, n. 272.

279 The role of competent national authorities and their relationship with the ESMA will be regulated under Arts. 26 *et seq*. of the proposal, *supra*, n. 272.

280 Arts. 22 and 23 of the proposal, *supra*, n. 272.

281 See Art. 17(1) of the proposal, *supra*, n. 272.

282 Art. 20 of the proposal, *supra*, n. 272.

283 Art. 19 of the proposal, *supra*, n. 272. The fall in value shall be 10% or more in the case of a share, and for other classes of financial instruments an amount to be specified by the Commission.

284 Art. 19(2) of the proposal, *supra*, n. 272.

285 *Supra*, at part 4(a).

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only intervene directly if national authorities fail to properly address an emergency situation.[286] However, emergency powers should probably not be exercised too lightly as some short selling strategies can actually help to mitigate systemic risks and market bubbles, rather than trigger them.

To achieve greater transparency, the proposed *Regulation* provides for detailed notification and disclosure requirements for any natural or legal person who has accumulated significant (in other words: systemically relevant) net short positions in shares,[287] regardless of whether that person is residing or established within or outside the EU.[288] The relevant threshold for notification to national authorities, which must be made no later than 3.30 pm on the next trading day,[289] is currently set at a percentage that equals 0.2 percent of the value of the issued share capital of the company concerned, and each 0.1 percent above that.[290] If a threshold of 0.5 percent (and each 0.1 percent above that) is reached, details of the position must also be disclosed to the public at large.[291] The form and method of notification and disclosure are subject to Article 9 of the proposal. A similar notification duty will apply to net short positions relating to the issued sovereign debt[292] of an EU Member State or of the Union itself, subject to a threshold yet to be specified by the Commission.[293] In exceptional situations, however, national authorities may even quite radically require all net short positions in relation to any type or class of financial instruments to be notified or disclosed to the public.[294]

During the consultation period, some market participants criticized these strict new transparency rules, anticipating that regulators would frequently be inundated with information of questionable systemic relevance due to relatively low information thresholds. At the same time, public disclosure of short positions at 0.5 percent is said to mislead the general public by bearing the erroneous perception that a security's price might be caught in a downward spiral whilst, in fact, the short position may be a simple hedge or a legitimate investment strategy requirement. As a result, the industry fears a decrease in trading volumes, interference with efficient price discovery and increased intraday volatility.[295]

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286 Art. 24 of the proposal, *supra*, n. 272.

287 Arts. 5 *et seq*. of the proposal, *supra*, n. 272.

288 Art. 10 of the proposal, *supra*, n. 272. As to the problem of extra-territorial application of EU law, which might also be attributed to this provision, see *supra*, n. 196.

289 Art. 9(2) of the proposal, *supra*, n. 272.

290 Art. 5(2) of the proposal, *supra*, n. 272.

291 Art. 7 of the proposal, *supra*, n. 272.

292 "Sovereign debt" means a debt instrument issued by the EU or a Member State, including any ministry, department, central bank, etc.; see Art. 2(1)(g) of the proposal, *supra*, n. 272.

293 Art. 8(1)(a) of the proposal, *supra*, n. 272.

294 Art. 16 and recital 5 of the proposal, *supra*, n. 272.

295 See the Managed Funds Association's response to the Consultation Paper, available online: <http://www.managefunds.org/international.asp>, at 5.

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CDS,[296] on the other hand, are said not only to entail significant counterparty risks, but also the risk that a buyer of protection might have an interest in trying to bring about a default, or the risk that the use of credit default swap transactions might lead to misprizing, disorderly markets or manipulation of the underlying bond market and (possibly) equity markets.[297] Buying CDS without having a long position in an underlying bond is also said to be equivalent to taking a short position on that bond.[298] The Commission is therefore willing to allow restrictions, predicated on emergency powers of competent national authorities, as well as certain notification and disclosure requirements for CDS, too.

Under Article 18 of the proposal, any person may be limited for a period of up to three months[299] from entering into a CDS transaction relating to an obligation of a Member State or the EU, if this is necessary to address adverse events or developments which constitute a serious threat to financial stability or market confidence. Under the same conditions, the value of uncovered CDS positions that a person may enter into can be curtailed. However, it should be emphasized that the proposal does not seek to entirely ban uncovered sovereign CDS trading.

Just like net short positions in shares and sovereign debt, competent national authorities must be notified of significant uncovered positions in CDS relating to an obligation of a Member State or the EU, if a notification threshold yet to be determined by the Commission is reached.[300] In addition, CDS will often qualify as OTC derivatives and, hence, will also fall within the ambit of the proposed OTC derivatives *Regulation*.[301] It follows that institutions trading in CDS must, on the one hand, report the details of any transaction entered into to a trade repository within one working day,[302] and, on the other hand, notify significant uncovered positions to competent national authorities. The frequency of the latter, albeit not

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296 According to Art. 2(1)(c) of the proposal, CDS means a derivative contract in which one party pays a fee to another party in return for compensation or a payment in the event of a default by a reference entity, or a credit event relating to that reference entity and any other derivative contract that has a similar economic effect; for an overview of different CDS types and structures see Sven Brandt, "Kreditderivate — Zentrale Aspekte innovativer Kapitalmarktprodukte" (2002) Zeitschrift für Bank- und Kapitalmarktrecht 243; see also Commission Staff Working Document (Impact Assessment) SEC (2010) 1055 of 15/9/2010, at 14 *et seq*., online: <http://ec.europa.eu/internal_market/securities/docs/short_selling/20100915_impact_assessment_en.pdf>.

297 See the Commission's initial Public Consultation Document on Short Selling, at 5, online: <http://ec.europa.eu/internal_market/consultations/docs/2010/short_selling/consultation_paper_en.pdf>.

298 Recital 13 of the proposal, *supra*, n. 272; see also Erik Sirri (SEC), "Testimony Concerning Credit Default Swaps" before the House Committee on Agriculture, 15/10/2008, online: <www.sec.gov/news/testimony/2008/ts101508ers.htm>.

299 Art. 20 of the proposal will apply, including the possibility of a renewal; *supra*, n. 282 and accompanying text.

300 Art. 8(1)(b) of the proposal, *supra*, n. 272.

301 *Supra*, part 6(c).

302 See Art. 6 of COM (2010) 484/5 of 15/9/2010, *supra*, n. 233.

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yet explicitly regulated under the proposal,[303] is probably going to be less stringent. In any event, the distinction between "transactions" and "positions" as regards applicable transparency requirements will be crucial.

Finally, Member States will be obliged and entitled to establish rules on administrative measures, sanctions and pecuniary penalties applicable to infringements of the provisions of the proposed *Regulation*, and must ensure that all necessary measures are implemented.[304] According to the Commission's plans, the new *Regulation* is to apply as from July 1, 2012.

(e) Miscellaneous

Apart from these topics, the Commission intends to present a variety of legislative measures designed to bring about further regulatory reforms in the field of capital markets and financial services. The vast majority of these measures are to be submitted by the end of 2010, and the last proposals are intended to be presented by spring 2011.[305]

For instance, the Commission will propose improvements to the *Markets in Financial Instruments Directive* (MiFID)[306] in order to strengthen pre- and post-trade market behaviour and (where appropriate) tackle irresponsible and excessive speculation. It will also revise the *Market Abuse Directive*[307] prohibiting insider trading and market manipulation and the *Financial Conglomerate Directive*,[308] introduce legislative proposals on packaged retail investment products[309] and amend both the *Investor Compensation Schemes Directive*[310] and the legislation applicable to the UCITS depositaries function.[311] Proposals for a review of the *Prospectus Directive*[312] are already underway.[313] Finally, the Commission is contemplating further legislative measures on remuneration issues for a variety of financial ser-

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303 Art. 9(2) does not apply as it merely relates to "net short positions", *i.e.*, trading in shares or sovereign debt.

304 Art. 35 of the proposal, *supra*, n. 272.

305 See COM (2010) 301 final, *supra*, n. 159 at 2. For a detailed overview of all forthcoming legislative projects see Annex 1 of COM (2010) 301 final.

306 *Directive* 2004/39/EC of 30/4/2004, *supra*, n. 58; for information on current developments in this field see online: <http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm>.

307 2003/6/EC of 28/1/2003, *supra*, n. 55.

308 *Directive* 2002/87/EC of 16/12/2002.

309 See online: <http://ec.europa.eu/internal_market/finservices-retail/investment_products_en.htm>.

310 1997/9/EC of 19/2/1997; on 12 July 2010, a Commission proposal for amendments was laid down, available online: <http://ec.europa.eu/internal_market/securities/isd/investor_en.htm>.

311 *Supra*, n. 47; see new *Implementation Directives* 2010/42/EU and 2010/43/EU of 1/7/2010 and *Implementation Regulations* (EU) No. 583/2010 and 584/2010 of 1/7/2010.

312 *Supra*, n. 49.

313 Online: <http://ec.europa.eu/internal_market/securities/prospectus/index_en.htm>.

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vices sectors, in particular UCITS and insurance companies.[314]

7. CONCLUDING REMARKS

The financial crisis and the ensuing financial disruptions have repeatedly been likened to a financial tsunami.[315] In turn, to stick with the metaphor, the financial tsunami triggered a legislative and regulatory tsunami — the epicenter being Basel and, with respect to EU banks, also Brussels — that threatens to inundate participants, *i.e.*, banks, regulators and supervisors, lawyers, and even innocent bystanders, such as academics. In particular, the several waves of regulation caused by the Basel Committee (enhancements to Basel II, Basel III) will affect all banks in the EU, not just a small number of large international banks. The large banks remaining will be simpler or, in the words of *Lord Turner*, the chairman of the U.K.'s Financial Services Authority (FSA), "a more boring investment — lower average return but lower risk".

However, even more stringent capital and liquidity regimes than currently envisaged, and the rules on remuneration designed at fostering a more long-term perspective by board members and personnel in key risk functions will not eliminate the class of financial institutions that markets, supervisory, governments, and taxpayers' wallets have focussed on since the financial crisis, *i.e.*, institutions that are "too big to fail" or too interconnected or systemically important for other reasons. How to deal with institutions that, because of the adverse consequences for the financial system and the economy at large, have to be protected at all costs, *i.e.*, ultimately by taxpayer's wallets, against failure has been of focal concern to supervisors and governments alike and, hence, the subject of on ongoing intense debate.[316] In this respect, as was aptly noted in November 2009 and still holds true at the moment, the EU institutions have not so far made any major contribution to the debate.[317] The U.S. lessons from the financial crisis — the *Dodd-Frank Wall Street Reform and Consumer Protection Act* — and the EU lessons outlined here differ substantially. The U.S. focussed on improving the regulatory regime, leaving a very complicated supervisory structure nearly untouched, whereas the EU has spent a lot of time and effort on improving an effective pan-European supervisory architecture or, more precisely, on setting-up an integrated European supervisory structure. To a very high degree these differences reflect the EU being a treaty-based supranational institution, not a federal state. For the EU, effective banking supervision in general and effectively dealing with the TBTF-problem in particular require adequate merit

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314 See the Commission *Green Paper* COM (2010) 284 final, *supra*, n. 155 at 17.

315 See *e.g.*, Andrea Beltratti & Rene M. Stulz, "Why Did Some Banks Perform Better During the Credit Crisis?" (Charles A Dice Center Working Paper No. 2009-12, Ohio State University, July 2009), at 2, available online: <http://ssrn.com/abstract=1433502>.

316 For an overview see Edward F. Greene, Knox L. Mcllwain & Jennifer T. Scott, "A closer look at 'too big to fail': national and international approaches to addressing the risks of large, interconnected financial institutions" (2010) 5 Capital Markets Law Journal 117.

317 Freshfields Bruckhaus Deringer, *The bank of the future* (2009) at 40, available online: <www.freshfields.com/industries/reports/bank_of_the_future>.

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regulation, but also integrated supervisory structures as well as mechanisms for an EU-wide reorganization of banks and banking groups. The extent of the challenge in this respect can be easily gleaned from the fact that some Member States, *e.g.*, the U.K., prefer banks to operate on their territory by setting up subsidiaries, not branches, precisely because such a structure allows ring-fencing of local assets at troubled banking groups or, at least, makes it much easier. Hopefully, a follow-up report on EU developments will have to report some progress in this area as well.

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