AUGUST 2010

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 152 – EUROPEAN FINANCIAL SUPERVISION: LEGAL RISKS

Analysis of certain core areas of the European Commission's proposals for European Financial Supervision which are capable of giving rise to significant legal uncertainty

Financial Markets Law Committee

c/o Bank of England

Threadneedle Street

London EC2R 8AH

www.fmlc.org

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 152 – Commission's proposals for European Financial Supervision

Working Group Members:

Patrick Buckingham	Herbert Smith LLP
David Entwistle	Deutsche Bank AG
Michelle Ewing	Financial Services Authority
Stephen Fletcher	Linklaters LLP
Victoria Hardy	Barclays PLC
Dorothy Livingston	Herbert Smith LLP
Bob Penn	Allen & Overy LLP
Carmen Reynolds	White & Case LLP
Alastair Sutton	White & Case LLP

FMLC Secretariat:[1]

Joanna Perkins	FMLC Director
Anne-Laure Condat	FMLC Acting Secretary
Sinéad Walley	FMLC Acting Secretary

1 Editorial support provided by Monika Kislowska (FMLC Research Assistant), Cerid Lugar (FMLC Legal Intern), Raunuk Wahiwala (FMLC Legal Intern) and Roland Susman (FMLC Legal Intern)

CONTENTS

1	INDEX OF DEFINED TERMS	4
2	INTRODUCTION AND EXECUTIVE SUMMARY	5
3	LEGAL BASIS OF THE PROPOSALS	7
4	IMPACT OF THE PROPOSALS	12
5	CONCLUSION	26

INDEX OF DEFINED TERMS

"Commission" means the European Commission

"EBA" means the European Banking Authority

"ECB" means the European Central Bank

"ECJ" means the Court of Justice of the European Union

"EIOPA" means the European Insurance and Occupational Pensions Authority

"ENISA" means the European Network and Information Security Agency

"ESAs" means the European Supervisory Authorities (EBA, EIOPA and ESMA)

"ESAs Regulations" means the Regulations establishing the EBA, the EIOPA and the ESMA, as set out in Section 1.4

"ESFS" means the European System of Financial Supervisors

"ESMA" means the European Securities and Markets Authority

"ESRB" means the European Systemic Risk Board

"FMLC" or "Committee" means the Financial Markets Law Committee

"FSA" means the Financial Services Authority

"FSMA" means the Financial Services and Markets Act 2000

"HMT" means Her Majesty's Treasury

"Proposals" means the Commission's package of proposals, published in September 2009, for European micro- and macro-prudential supervision

"Treaty" means the Treaty on the Functioning of the European Union

1 INTRODUCTION AND EXECUTIVE SUMMARY

A. Introduction

1.1 The role of the FMLC is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2 In October 2008, in light of the financial crisis, the President of the Commission José Manuel Barroso asked a group of high-level experts chaired by Jacques de Larosière to make recommendations with a view to establishing a new more efficient, integrated and sustainable supervisory framework for the financial system in the EU.[2]

1.3 The key recommendations of the de Larosière Group were:

(a) the establishment of an ESRB responsible for macro-prudential oversight of the financial system within the EU; and

(b) the establishment of an ESFS consisting of a network of national financial supervisors working with new ESAs responsible for micro-prudential oversight of the financial system within the EU.[3]

1.4 Following these recommendations, in September 2009, the Commission published Proposals which recommend, *inter alia*, making further provision in the form of:

---

2 Report by the high-level group on financial supervision in the EU chaired by Jacques de Larosière (25 February 2009)

3 The ESAs will be created by the transformation of existing European supervisory committees; the Committee of European Banking Supervisors ("CEBS") into the European Banking Authority ("EBA"), the Committee of European Insurance and Occupational Pensions Supervisors ("CEIOPS") into the European Insurance and Occupational Pensions Authority ("EIOPA") and the Committee of European Securities Regulators ("CESR") into the European Securities and Markets Association ("ESMA").

(a) a Regulation on Community macro-prudential oversight of the financial system and to establish the ESRB;[4]

(b) a Regulation to establish the EBA;[5]

(c) a Regulation to establish the EIOPA;[6] and

(d) a Regulation to establish the ESMA.[7]

1.5 The purpose of this paper is to highlight a number of provisions in the Proposals which are capable of giving rise to significant legal uncertainty unless amended and/or clarified.

B. Executive Summary

1.6 This paper does not seek to address all ambiguities and uncertainties generated by the Proposals; nor does it seek to identify exhaustively all potential concerns with respect to the issues raised. The purpose of this paper is to highlight certain fundamental issues which could, in the FMLC's view, create significant legal uncertainty and, possibly, provide grounds for a challenge to future decisions of the Commission and/or any of the ESAs, unless the Proposals are appropriately amended or further EU legislation adopted.

1.7 The FMLC's main areas of concern are summarised below. Issue (a) relates to the legal basis of the Proposals under EU law and is considered below under "Legal Basis of the Proposals". Issues (b) to (g) relate to the impact of the Proposals on the regulatory regime across the Member States and each of these issues is considered below under "Impact of the Proposals".

(a) The legal basis of the Proposals under EU law pursuant to the Treaty and established case law of the ECJ, in particular the powers given to the Commission and the ESAs under Articles 9-11 of the ESAs Regulations.

---

4 2009/0140 (COD)
5 2009/0142 (COD)
6 2009/0143 (COD)
7 2009/0144 (COD)

(b) The uncertainty as to which legislation (i.e. the EU directives or national laws) will be applied to national competent authorities and financial institutions.

(c) The uncertainty for financial institutions supervised by both their national competent authority and the ESAs and whether the ESAs' powers will undermine the ability of competent authorities to discharge their regulatory functions.

(d) Confidentiality issues relating to the Proposals.

(e) Concerns relating to the appeal process of ESA decisions as set out in Chapter V of the ESAs Regulations (*Remedies*).

(f) Concerns over the immunity granted to the ESAs in the exercise of their powers and whether it should be strengthened to deter potential litigation.

(g) Uncertainty as to the scope of the ESAs' powers in relation to EU-based branches of non-EU incorporated financial institutions.

2 LEGAL BASIS OF THE PROPOSALS

Legal basis under EU law for the powers given to the Commission and the ESAs under Articles 9-11 of the ESAs Regulations[8]

Under Articles 9-11 of the Proposals, the ESAs will have the power to "adopt" decisions (i) "requiring competent authorities to take the necessary action" to address risks relating to the functioning and integrity of the financial markets or the stability of the financial system or to settle disagreements between competent authorities, and (ii) "addressed to" financial institutions requiring the necessary action for such institutions to comply with their obligations under EU law.[9]

---

8 Article 9 (*Consistent application of Community rules*), Article 10 (*Action in emergency situations*) and Article 11 (*Settlement of disagreements between competent authorities*)

9 Articles 9(6), 10 (2), 10(3), 11(3) and 11(4) of the ESAs Regulations

The ESAs Regulations use the concept of "addressing a decision" to a financial institution. Although this concept may be linguistically inelegant, we understand that it is intended to mean "taking a decision binding on" a financial institution.

The Commission will also have powers to take decisions requiring competent authorities to take actions necessary to comply with EU law and to determine the existence of an emergency situation (which in turn will trigger some of the above powers of the ESAs).[10]

The Commission's Proposals are based on Article 114 of the Treaty, which provides that the European Parliament and the Council shall:

> *"adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market".*

The creation of a body (such as the ESAs) *"for the approximation of the provisions laid down by law"* pursuant to Article 114 of the Treaty has been recognised by the ECJ in a case brought by the UK in 2004 seeking the annulment of a Council Regulation establishing the ENISA.[11] The ECJ provided that:

> *"the legislature may deem it necessary to provide for the establishment of a Community body responsible for contributing to the implementation of a process of harmonisation in situations where, in order to facilitate the uniform implementation and application of acts based on that provision, the adoption of non-binding supporting and framework measures seems appropriate".*

However, the powers given to the ENISA in this particular case were limited and the ECJ emphasised that tasks conferred on agencies "*must be closely linked to the subject-matter of the acts approximating the laws, regulations and administrative provisions of the Member States*". If challenged, the ESAs' powers to take decisions binding on

---

10 Article 9(4) and 10(1) of the ESAs Regulations

11 Case C-217/04 *UK v European Parliament and Council*

competent authorities of Member States and financial institutions may be considered to go beyond such standards.

In addition, the ECJ case of *Meroni* established that (i) an institution may not delegate powers that it does not itself possess and (ii) an institution may delegate only clearly defined executive tasks.[12] Applying these principles to the Commission's delegation of powers to the ESAs;

(a) In relation to the ESAs' powers to take decisions binding on competent authorities, the Commission does not have the power (except where expressly conferred, such as under Article 108 of the Treaty in relation to State Aid) under the Treaty to determine that a Member State (or an authority thereof) is in breach of EU law and make a binding decision in this respect.[13] Breaches of EU law by Member States are dealt with under Articles 258-260 of the Treaty and only give the Commission the power to give an opinion on the matter. Only the ECJ has the power under the Treaty to find that a Member State is in breach of EU law. As the Council does not have such power, it would not, in light of the restrictions established in *Meroni*, be able to delegate it to the Commission pursuant to a regulation.[14] Therefore, the delegation of such powers to the ESAs, as well as the Commission's own powers to take decisions binding on competent authorities, may be successfully challenged on this basis unless such powers are granted pursuant to an amendment to the Treaty. Even if the Commission had the power to take decisions binding on competent authorities, delegation of such power to the ESAs may go beyond "clearly defined executive tasks" and therefore be challenged on that basis.

(b) In relation to the ESAs' powers to take decisions binding on financial institutions, it is unclear whether the Commission has such powers and therefore

---

12 Case 9/56 *Meroni v High Authority* [1958] ECR 133

13 Bodies under the control of a Member State and independent bodies entrusted by the Member State with carrying out its Community obligations are the responsibility of the State if they do not comply with Community obligations: this applies to any "*agency of the State whose action or inaction is the cause of the failure to fulfil its obligations, even in the case of a constitutionally independent institution*" (Case 77/69 *Commission v Belgium*)

14 The FMLC is aware that the text of the Proposals agreed at the ECOFIN meeting on 2 December 2009 provides in Art 9(4) for the Commission to give a formal opinion rather than a decision on whether a competent authority has failed to comply with EU law.

whether it would be able to delegate them to the ESAs. The Commission may derive such powers from Article 291 of the Treaty, which provides that:

> *"[w]here uniform conditions for implementing legally binding Union acts are needed, those acts shall confer implementing powers on the Commission..."*

If Article 291 were to be relied on as the legal basis for the Commission's powers to make decisions which bind financial institutions and which can, within the *Meroni* restriction, be delegated to another body, such delegation by legislation would nonetheless need to comply with paragraph 3 of Article 291. Paragraph 3 provides that:

> *"the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall lay down in advance the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers".*

As the Proposals do not provide such mechanisms, the legal basis for the Commission's powers to take such binding decisions is unclear. If the Proposals were amended to provide the relevant control mechanism required under Article 291, the delegation of such powers by the Commission to the ESAs might still be susceptible to challenge on the grounds that it goes beyond "clearly defined executive tasks". As such, the ESAs may be restricted to assisting the Commission in the exercise of its decision-making powers (e.g. limited to making recommendations to the Commission).

It appears to the FMLC that significant legal uncertainty exists in relation to the constitutional authority and justification for some aspects of the Proposals. In particular, if any question arises as to the validity of the ESAs Regulations and/or any challenges or actions taken by the Commission and/or the ESAs pursuant to their powers under the ESAs Regulations, theoretical uncertainty is likely to develop into widespread market operational uncertainty, with all that this might entail. To avoid such a problem arising, a number of solutions might be considered, although none of them would be easy to implement.

(a) The Treaty might be amended so that the powers set out in the Proposals are granted to the Commission and the ESAs. This is likely to be very difficult to achieve in practice owing to the idiosyncrasies of Member States' domestic legal systems which may contain rules requiring ratification or amendment of constitutional EU law treaties.

(b) Alternatively, Article 352 of the Treaty provides that:

> *"[i]f action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures".*

As a method for endorsing and legitimising the Proposals, this process is likely to prove more difficult to use successfully than relying on Article 114, as it would require unanimous approval of the 27 Member States represented at the Council.

(c) The Proposals might be amended to grant the powers currently given to the ESAs to the ECB, which does have direct powers against credit institutions. However, such powers would be limited to credit (i.e., broadly, deposit taking) institutions and the relevant provision (Article 127(6) of the Treaty), which allows the Council to confer on the ECB certain tasks relating to the prudential supervision of credit institutions and other financial institutions (but not insurance companies), also requires unanimity of all 27 Member States in any case.[15]

---

15 Note that pursuant to Protocol No 15 (on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland), the UK is not bound by a number of other relevant provisions in the Treaty and Protocol No 4 (on the Statute of the European System of Central Banks and the European Central Bank). Article 127(6) is one of the few provisions in this area where the opt-out does not apply. Under paragraph 3 of Protocol No 15, the UK retains its powers in the field of monetary policy under national law.

3 IMPACT OF THE PROPOSALS

3.1 Uncertainty as to which legislation (EU directives or national laws) will be applied to competent authorities and financial institutions

3.1.1 If the Commission and the ESAs were to be granted the powers as set out in the Proposals, there may be uncertainty as to the "local sensitivity" of the standards applicable to competent authorities and financial institutions. The powers given to the Commission and the ESAs in the Proposals are conferred in circumstances (i) where a competent authority has not correctly applied "*the legislation referred to in Article 1(2)*"; and (ii) where a financial institution has failed to comply with requirements of the legislation referred to in Article 1(2) where such requirements are "*directly applicable to financial institutions*".[16]

3.1.2 Unlike EU legislation in the competition law sector (which, for historical reasons, is dealt with at EU Treaty and regulation level), EU legislation in the financial sector is mainly in the form of directives, referred to as the "sectoral directives". Each Member State has implemented these sectoral directives into its national law in a different manner.

3.1.3 The ESAs Regulations appear to suggest that the standards set out in the sectoral directives themselves will be applied by the Commission and the ESAs ("*the legislation referred to in Article 1(2)*")—rather than the rules which implement them—when dealing with the competent authority or financial institution of any such Member State.

3.1.4 However, national competent authorities and financial institutions will still be subject to the national rules implementing the relevant directives in their "home" Member State, which may create legal uncertainty as to which standards will be applicable (i.e. the EU legislation or the national rule) in circumstances where the relevant EU legislation is set out in a directive rather than a regulation (and therefore is not directly applicable).

---

16 Article 1(2) refers to a number of EU Directives and all directives, regulations, and decisions based on these acts and any further Community act which confer tasks on the ESAs.

3.1.5 In order to avoid legal and regulatory uncertainty in this respect, a number of solutions may be explored.

(a) The sectoral directives might be replaced with an overarching EU Regulation applicable to all Member States in the same manner. However, this is likely to be difficult in practice owing to certain Member States' preference for adopting national and localised standards, where possible, in relation to financial services regulatory issues.

(b) The Proposals and/or the sectoral directives might be amended to clarify which standards will be applied to competent authorities and financial institutions, and how the national laws and each relevant sectoral directive will interact in the event of conflict.

3.2 Uncertainty for financial institutions supervised by their national competent authority and the ESAs and whether the ESAs' powers will undermine the ability of competent authorities to discharge their regulatory functions

As mentioned in Section 2 above, the ESAs Regulations use the concept of "adopting" a decision "addressed to a financial institution", which we use here in order accurately to track the legislative intention of the Commission, but which we understand to mean "taking a decision binding on" a financial institution.

3.2.1 Article 9(6) of the ESAs Regulations provides the ESAs, in effect, with the right to intervene directly in the regulation of financial institutions, by-passing the national authority, in cases where the relevant competent authority has not correctly implemented the legislation referred to in Article 1(2) and has not complied with the ESA decision requiring it to implement this legislation

correctly.[17] Article 11(4) of the ESAs Regulations provides a similar right following a disagreement between competent authorities.[18] Article 10(3) of the ESAs Regulations provides a more wide-ranging power for the ESAs to intervene—i.e to "adopt an individual decision addressed to" financial institutions—in the case of emergency situations, where the relevant competent authority has not complied with the ESAs' decision.[19] Where an "individual decision addressed to a financial institution" is adopted under any of these articles, there will be a dispute as to the right approach to the implementation of European law between the ESAs and the national competent authority.

3.2.2 As has been demonstrated by recent events, the failure of a competent authority to apply European legislation in the spirit in which it was drafted may arise from broader political pressures—particularly in emergency situations.[20] Where this

---

17 *Article 9(6) – Consistent application of Community rules*
Without prejudice to the powers of the Commission under Article 226 of the Treaty, where a competent authority does not comply with the decision referred to in paragraph 4 of this Article within the period of time specified therein, and where it is necessary to remedy in a timely manner the non compliance by the competent authority in order to maintain or restore neutral conditions of competition in the market or ensure the orderly functioning and integrity of the financial system, the [ESA] may, where the relevant requirements of the legislation referred to in Article 1(2) are directly applicable to financial institutions, adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Community law including the cessation of any practice.

18 *Art 11(4) – Settlement of disagreements between competent authorities*
Without prejudice to the powers of the Commission under Article 226 of the Treaty, where a competent authority does not comply with the decision of the [ESA], and thereby fails to ensure that a financial institution complies with the requirements directly applicable to it by virtue of the legislation referred to in Article 1(2), the [ESA] may adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Community law including the cessation of any practice.

19 *Art 10(3) – Action in emergency situations*
Without prejudice to the powers of the Commission under Article 226 of the Treaty, where a competent authority does not comply with the decision of the [ESA] referred to in paragraph 2 within the period laid down therein, the [ESA] may, where the relevant requirements of the legislation referred to in Article 1(2) are directly applicable to financial institutions, adopt an individual decision addressed to a financial institution requiring the necessary action to comply with its obligations under Community law including the cessation of any practice.

20 Emergency situations (such as the collapse of Lehman Brothers Holdings Inc. or, on a smaller scale, the Icelandic bank Landsbanki Íslands hf. being placed into receivership) have provided ample illustration of the Governor of the Bank of England's phrase that global—and, one might add, European—banks are "global [or European] in life but national in death". They also illustrate national authorities' reluctance to be constrained by European competition law or to accommodate the full implications of "passporting" and "home state" regulation in an emergency context.

is the case, the competent authority may seek to take action to incentivise the financial institution to act in breach of the relevant ESA decision.

3.2.3 If a competent authority does not comply with an ESA decision and the relevant ESA adopts an individual decision addressed to a financial institution which conflicts with the competent authority's requirements, the affected financial institution and its senior management will need certainty that compliance with the ESA decision will not open them to disciplinary action or sanctions from the competent authority or under the law of the relevant Member State. Whilst it seems likely that action taken directly in contravention of the ESA decision by the competent authority would not be upheld by the Member State's courts, there remains the risk of other actions being taken to incentivise the financial institution not to comply with the ESA decision—such as disciplinary action levied against senior management.

3.2.4 The ESAs Regulations should therefore clarify what will occur in the event of an action taken by a competent authority which is in breach of, or inconsistent with, an ESA decision addressed to a financial institution, or which imposes sanctions in relation to the implementation of such a decision. One possible clarification would be for the ESAs Regulations to provide that any such action by a competent authority will be of no effect.

3.2.5 While the ESAs' power to "adopt an individual decision addressed to a financial institution" is currently framed in such a way that it only applies where a Member State's competent authority has failed to comply with a formal opinion of the Commission requiring it to take action to comply with EU law, its existence does raise a number of concerns for both financial institutions and Member States' competent authorities.

3.2.6 In particular, it is important that there be a high degree of transparency and clarity as to the circumstances in which the ESAs would adopt individual decisions in the exercise of this power. Clarification in the ESAs Regulations that the adoption of these decisions is merely a last resort, such that they would be a comparatively rare occurrence in practice, would be helpful. In the absence of such clarity, a significant degree of regulatory uncertainty for financial

institutions arises from the ever-present risk of direct regulatory intervention by the relevant ESA. At worst, this could significantly diminish the confidence placed by locally regulated financial institutions in the finality of the supervisory actions taken by their Member State's competent authority and thereby undermine the authority of such competent authorities. The risk of regulatory uncertainty is clearly more pronounced in relation to issues for which there may be known to be differing views and interpretations in different Member States.

3.2.7 Any decision of an ESA that applied directly to a particular financial institution would naturally be of great interest to other financial institutions in that Member State, the competent authority in that Member State and financial institutions and competent authorities in other Member States. It is therefore vital that the ESAs Regulations fully clarify the status and application of any such decision *vis-à-vis* financial institutions and Member States' competent authorities. It is unclear whether the intention of paragraph 7 of Article 9 of the ESAs Regulations is to require the Member State's competent authority responsible for the financial institution in question and other Member States' competent authorities elsewhere in the EU to adjust their supervisory decisions and practices so that they accord with the detail of the decision adopted by the ESA.[21] If this is the case, in view of the importance of this issue, the Commission should clarify how it expects paragraph 7 of Article 9 of the ESAs Regulations to operate in practice and consider whether the legislative drafting should be clarified in the interest of providing greater legal certainty as to its operation. Without an appropriate degree of clarity, a state of regulatory uncertainty and inertia could develop if Member States' competent authorities and financial institutions across the EU do not know how they should respond to

---

21 *Article 9(7) – Consistent application of Community rules*
Decisions adopted under paragraph 6 shall prevail over any previous decision adopted by the competent authorities on the same matter.
Any action by the competent authorities in relation to facts which are subject to a decision pursuant to paragraph 4 or 6 shall be compatible with those decisions.

a given decision adopted by an ESA in relation to a particular financial institution.[22]

3.3 Confidentiality issues associated with the Proposals

3.3.1 It is vital that adequate safeguards be included in the ESAs Regulations to ensure that any confidential information relating to a financial institution provided to an ESA by a Member State's competent authority or the institution itself retains its confidential character and can only be used or disclosed by the ESA in limited circumstances connected to the proper discharge of its functions. While the professional secrecy obligations included in each of the ESAs Regulations go some way to addressing these concerns, further consideration should be given to the way in which these obligations will interact with the professional secrecy obligations included in the existing EU legislation applicable to financial market participants. Furthermore, proper consultation should be undertaken by each ESA in relation to the internal procedural rules that it devises to implement the confidentiality rules included in the relevant Regulation under which it is established.

3.3.2 At present, the confidentiality provisions included in the existing European legislation applicable to financial market participants are not consistently framed. These inconsistencies should be eliminated and the procedural rules devised by each ESA (to implement the confidentiality provisions in the underlying EU legislation) should be consistent across the three ESAs.

3.3.3 Specifically, it is important to secure appropriate protection of firm-specific confidential information within the ESAs, particularly given their close working relationship with the Commission and the ESRB. Where the ESAs are exercising their decision-making powers, Article 29(4) of the ESAs Regulations does provide for non-voting members, such as the Commission, to be generally

---

22 This is particularly relevant in the UK context, given the publication on 26 July of HMT's consultation paper: "A new approach to financial regulation: judgement, focus and stability", which was launched to gather views on the UK Government's proposals to reform the UK's financial regulatory framework. Although the consultation makes very little reference to the proposed EU financial supervision framework, any lack of clarity at the EU level will also impact the new financial regulation framework in the UK.

excluded from discussions relating to individual institutions.[23] It would be helpful to make it explicit that, in addition to non-participation in discussions, non-voting members should not have access to documents or other information concerning individual institutions.

3.3.4 In the context of Article 9 of the ESAs Regulations *(Consistent Application of Community rules)* and investigations leading up to Commission decisions or formal opinions, there are no specific safeguards preventing confidential information from flowing into the Commission's hands. It seems likely that the ESAs will need to have regard to information relating to individual financial institutions when taking action under Article 9 of the ESAs Regulations and it is important that such information should not be disclosed to the Commission. One solution might be to add the following to Article 9(3):[24]

> *"The [ESA] shall not divulge confidential information concerning individual financial institutions (except in summary or collective form, such that individual financial institutions cannot be identified) to the Commission in connection with the performance of its tasks under this Article without the consent of the institution concerned".*

---

23 *Article 29(4) – Decision making*
The rules of procedure shall set out in detail the arrangements governing voting, including, where appropriate, the rules governing quorums. The non-voting members and the observers, with the exception of the Chairperson and the Executive Director, shall not attend any discussions within the Board of Supervisors relating to individual financial institutions, unless otherwise provided for in Article 61 or in the legislation referred to in Article 1(2).

24 *Article 9(3) – Consistent application of Community rules*
The [ESA] may, at the latest within two months from initiating its investigation, address to the competent authority concerned a recommendation setting out the action necessary to comply with Community law.
The competent authority shall, within ten working days of the receipt of the recommendation, inform the [ESA] of the steps it has taken or intends to take to ensure compliance with Community law.

This would be in line with the approach in Article 29 of the ESAs Regulations, where non-voting members—such as the Commission—are denied access to information relating to financial institutions.[25]

3.4 Concerns over the appeal process in Chapter V of the ESAs Regulations (Remedies)

Standing to bring an appeal in relation to decisions addressed to a competent authority

3.4.1 The right to appeal under Article 46(1) of the ESAs Regulations against an ESA decision made under Article 9, 10 or 11 of the same is available to any natural or legal person, including competent authorities, where the decision in question is "addressed to" that person or where it is addressed to another person but is of direct and individual concern to that first person.[26] In practice, however, the right of appeal will most likely only be available to the person to whom a decision is addressed.[27]

In the case of a decision addressed to a competent authority, financial institutions under the supervision of that competent authority (or other persons who may wish to appeal the decision) will not be addressees of the decision and therefore will need to rely on "direct and individual concern" to bring an appeal. Both direct concern and individual concern have been narrowly interpreted by the ECJ. Direct concern, as expressed in *Les Verts v Parliament,* requires that an applicant must be able to show that, at the time the contested act was adopted,

---

25 As regards the ESRB, whilst there is some scope for Commission members of the General Board to receive firm-specific confidential information under Article 5 (*Collection of information on behalf of the ESRB*) of the Council's Compromise version dated 21 January 2010 of the Regulation entrusting the ECB with specific tasks concerning the functioning of the ESRB, there is a clear prohibition contained in Article 6(1) (*Confidentiality of data and documents*) providing that any confidential information received by members of the ESRB may not be divulged on "to any person or authority whatsoever" except in summary or aggregated form, such that individual financial institutions cannot be identified.

26 Article 9 (*Consistent application of Community rules*), Article 10 (*Action in emergency situations*) and Article 11 (*Settlement of disagreements between competent authorities*).

27 *Article 46(2) - Appeals*
Any natural or legal person, including competent authorities, may appeal against a decision of the [ESA] referred to in Article 1(2) which is addressed to that person, or against a decision which, although in the form of a decision addressed to another person, is of direct and individual concern to that person.

the effect it would produce on them was substantially certain. Unless the decision addressed to the competent authority specifically states what action the ESA requires the competent authority to take, with no discretion on the part of the competent authority, this is unlikely to be the case.[28]

The basic test of "individual concern" is that set out in *Plaumann* (as amended by *Deutz*), namely that:

> *"the measure must affect a person's legal position because of a factual situation which differentiates them from all other persons and distinguishes them individually in the same way as a person to whom it is addressed".*[29]

The ECJ has expanded on this test in *Netherlands Antilles* to state that in order to meet the test for individual concern, a person must show that s/he is affected by reason of a factual situation that differentiates them from all other persons.[30] This is not possible where the impact of a measure on all affected parties is the same. Where an ESA decision is addressed to a competent authority, it may be that certain financial institutions are substantially certain of the effect that such a decision will have on them. However, even in instances where there has been a very narrowly defined and closed class of persons actually affected by a measure, the ECJ has been reluctant to find "individual concern".

Given the potentially severe impact that an ESA decision under Articles 9, 10 or 11 of the ESAs Regulations could have on financial market participants in an emergency situation, standing to bring an appeal against a decision should be broadened.

Standing to bring an appeal in relation to decisions addressed to a third party

3.4.2 The same tests and restrictions would apply *mutatis mutandis* to decisions addressed to individual financial institutions, meaning that in practice the only person likely to be properly placed to bring an appeal would be the financial

---

28 Case 294/83 *Parti Ecologiste Les Verts v Parliament*

29 Case 25/62 *Plaumann & Co v Commission* and Case 26/86 *Deutz und Gelderman v Council*

30 Case 142/00 P *Commission v Netherlands Antilles*

institution addressed by the decision. Where a decision addressed to a competent authority or financial institution is capable of affecting the interests of a third party, the third party should be able to bring an appeal.

Grounds for appeal

3.4.3 As set out above, Article 46(1) of the ESAs Regulations (*Appeals*) provides the right of appeal against a decision of an ESA made under Article 9, 10 or 11 of the same. The grounds for appeal are not specified but one would expect that an appeal against an ESA's decision could be made where the ESA has not complied with the requirements of the article permitting that decision.

3.4.4 An appeal against an ESA decision made under Article 9 of the ESAs Regulations may give rise to problems of competence. Section 2 above dealing with the legal basis of the Proposals considers the argument that the Council does not have the power to decide issues of compliance with EU law and therefore may not properly delegate that power to the Commission. A decision made by an ESA under Article 9(6) of the ESAs Regulations presupposes the validity of a Commission decision under Article 9(4). If an appeal were to be made against an ESA decision under Article 9(6) on the grounds that the prior Commission decision under Article 9(4) was invalid, then the Board of Appeal would, in effect, be asked to review the legality of a Commission decision, which it would not have the power to do.

3.4.5 The grounds for appeal, and the scope of the Board of Appeals' competence when considering an appeal, should therefore be made clear in the ESAs Regulations.

Timing of appeals

3.4.6 The length of time afforded to the Board of Appeal to decide upon an appeal is unsatisfactory. As referred to above, Article 10 of the ESAs Regulations (*Action in emergency situations*) provides that an ESA may, in an emergency situation (as determined by the Commission), address decisions to a competent authority or to a financial institution requiring or prohibiting action in order to ensure compliance with the legislation referred to in Article 1(2) of the ESAs

Regulations (*Establishment and Scope of action*). Under Article 10, an emergency situation may be determined by the Commission to be in existence in the case of adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the EU.

3.4.7 In such a situation, it is obviously important that a person subject to a decision be able to resolve any doubts it may have as to the validity of that decision immediately, as an improperly made decision could be very damaging to the addressee and other market participants. The two month window given to the Board of Appeal under Article 46(2) of the ESAs Regulations is therefore too long in the case of appeals made against an ESA decision under Article 10 of the ESAs Regulations.[31] This problem is exacerbated by the fact that lodging an appeal against a decision does not have a suspensory effect on that decision while the appeal is pending.

Suspensory effect

3.4.8 A contested decision is not suspended while an appeal is made (Article 46(3) of the ESAs Regulations), which is by no means a standard position: an appeal against a decision of the Office for Harmonization in the Internal Market, for example, has a suspensory effect, as does an appeal against a decision of the European Chemicals Agency.[32]

3.4.9 As highlighted above in relation to the timing of appeals, the lack of suspensory effect in this case is unsatisfactory because a binding decision may be made in an emergency situation under Article 10 of the ESAs Regulations against a competent authority or an individual financial institution. Despite the fact that,

---

31 *Article 46(2) – Appeals*
The appeal, together with the statement of grounds thereof, shall be filed in writing at the [ESA] within two months of the day of notification of the decision to the person concerned, or, in the absence thereof, of the day on which the [ESA] has published its decision.
The Board of Appeal shall decide upon the appeal within two months after the appeal has been lodged.

32 *Article 46(3) – Appeals*
An appeal lodged pursuant to paragraph 1 shall not have suspensive effect.
The Board of Appeal may, however, if it considers that circumstances so require, suspend the application of the contested decision.

notwithstanding the evident urgency in such an emergency situation, the Board of Appeal may take up to two months to consider an appeal, the ESA decision is not guaranteed to be suspended pending the Board of Appeal's decision.

3.4.10 The Board of Appeal may, if it considers that the circumstances so require, suspend the application of the contested decision. No guidance is given as to the circumstances in which the Board of Appeal may consider that suspension of the decision is required. This lack of guidance is, however, consistent with other regulations where a right of appeal is provided but suspensive effect while the appeal is made is not automatic (for example in Regulation No 1592/2002 of the European Parliament and of the Council of 15 July 2002 dealing with the European Aviation Safety Association).

3.4.11 The same position (i.e. that decisions are not suspended for the duration of an appeal) is taken regarding direct actions before the ECJ (Article 278 of the Treaty).[33] The ECJ may suspend a measure and, when considering whether to suspend a measure, will look for a *prima facie* case (i.e. a case where it cannot reasonably be said that the case is without foundation). Upon finding a *prima facie* case, the ECJ will consider the urgency resulting from the likelihood of irreparable damage to the applicant should the measure not be suspended. Such urgency is balanced against the possibility of irreparable damage to the Community should the measure be suspended but the applicant's case subsequently fail. One would expect that a similar balancing exercise will be undertaken by the Board of Appeal but, as this is not explicitly stated, this may not necessarily be the case.

3.4.12 Given the importance of suspensory effect to those affected by decisions, if there is no automatic suspension of the decision once an appeal is made, clarity as to the basis for the Board of Appeal's decision to suspend or not suspend a measure should be provided.

---

33 Actions brought before the ECJ shall not have suspensory effect. The ECJ may, however, if it considers that circumstances so require, order that application of the contested act be suspended.

Privacy of appeals

3.4.13 It is common for boards of appeal to publish their decisions. This is not, however, universally the case. The European Chemicals Agency publishes its decisions unless it decides otherwise after a reasoned request by one of the parties. Similar provision should be made regarding decisions of the Board of Appeal so that an appellant may apply for a decision of the Board of Appeal to be kept private where it can present a case for such privacy.

3.5 The Proposals should clarify the level of immunity granted to the ESAs

3.5.1 Article 55 of the ESAs Regulations (*Liability of the Authority*) provides for the liability of the ESAs as follows:

> *"In the case of non-contractual liability, the [ESA] shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by it or by its staff in the performance of their duties. The Court of Justice shall have jurisdiction in any dispute over the remedying of such damage".*

3.5.2 The extent of immunity enjoyed by different national competent authorities varies across Member States and thus it is not clear how far the immunity will extend under Article 55 of the ESAs Regulations. Many national competent authorities are granted specific additional immunity protection given the potential for significant liability or distracting litigation claims that may attach to them in the event of the insolvency of a financial services firm.

3.5.3 Considering the UK as an example, the FSA has specific immunity given to it pursuant to the FSMA. Section 19 of Schedule 1 (*The Financial Services Authority*) Part IV (*Exemption from liability in damages*) of the FSMA provides that:

> *"Neither the [FSA] nor any person who is, or is acting as, a member, officer or member of staff of the [FSA] is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the [FSA]'s functions".*

Such immunity is however subject to the relevant act or omission of the FSA (or person acting as a member, officer or member of staff thereof) being shown to have been in bad faith or a breach of the Human Rights Act 1998.

3.5.4 The 2006 Basel Core Principles for Effective Banking Supervision also recognise the need for legal protection for supervisors (see principle 1). The Core Principles Methodology indicates that this means that the law provides protection to the supervisory authorities and their staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.

3.5.5 Given the powers granted to the ESAs under the Proposals, enhanced clarity as to the level of their immunity may also be desirable.

3.6 Creation of parallel regulatory regimes for EU institutions and EU-based branches of non-EU incorporated entities

3.6.1 Although this issue is not specific to the Proposals, there may be a degree of uncertainty as to the scope of the ESAs' and the Commission's powers with regard to EU-based branches of non-EU incorporated entities to the extent that these may pose a risk to the European financial system.

3.6.2 For example, the ESA Regulation establishing the EBA applies to "credit institutions", "investment firms" and "financial conglomerates".[34] Whilst it would appear that the intention is that EU-based branches of non-EU incorporated institutions will be subject to the powers of the ESAs where they fall within any of the above definitions, the position is less clear in relation to deposit taking institutions which do not engage in lending activities (and thus would not fall within the definition of "credit institutions") and firms which only provide ancillary services under MiFID.

---

34 "Credit institutions" is defined in the directive relating to the taking up and pursuit of the business of credit institutions (2006/48/EC), "Investment firms" is defined in the directive on the capital adequacy of investment firms and credit institutions (2006/49/EC) and "Financial conglomerates" is defined in the directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (etc.) (2002/87/EC)

4 CONCLUSION

4.1 It is not the role of this Committee to comment on policy questions in relation to the substance or application of the Proposals. This paper is intended to assist those involved in policy decisions by drawing attention to the most significant elements of legal uncertainty that arise out of the Commission's Proposals.

4.2 It is essential, if the Proposals are to be successful, that there is no doubt as to the constitutional or legal basis on which they rest, in order to avoid the possibility of decisions by EU authorities being challenged. Equally there should be no legal and/or practical uncertainty as to the application of the Proposals, for example, as to the legislation which will be applicable to competent authorities and financial institutions, as to the interaction of the ESAs' and competent authorities' decisions, as to how confidentiality issues will be resolved or as regards uncertainty surrounding the appeal process. Whilst this paper has focused on the uncertainties inherent in certain core areas of the Commission's Proposal, the FMLC is aware that a number of other ambiguities and uncertainties have been identified in submissions by other parties. The FMLC considers that every effort to resolve these issues of legal uncertainty should be made during the co-decision process.

5 POSTSCRIPT

In addition to the above, there is a wider issue—which may potentially give rise to important policy concerns beyond the competence of the FMLC—as to who (i.e. an ESA or a Member State authority) would step in to deal with an ESA-supervised entity in the event of its default/insolvency. Were an ESA to step in, sub-issues also arise as to which powers it would have, how it would liaise with national authorities (given that Member States will also be interested in intervening in the interests of their local market) and what funds would be made available to it (whether the proposed default funds in the context of the Commission's proposals for cross-border bank resolution for instance would be available, or whether the funding would be left to Member States).

FINANCIAL MARKETS LAW COMMITTEE MEMBERS[35]

Lord Hoffmann (Chairman)

Sir John Gieve (Deputy-Chairman)

Andrew Bailey, Bank of England

Sir William Blair

Michael Brindle QC, Fountain Court

Charles Clark, Linklaters LLP

Simon Dodds, Deutsche Bank AG

Ruth Fox, Slaughter and May

Simon Gleeson, Clifford Chance LLP

James Grand, Freshfields Bruckhaus Deringer LLP

Ed Greene, Cleary Gottlieb Steen & Hamilton LLP

David Greenwald, Goldman Sachs International

Mark Harding, Barclays Bank plc

David Lawton, Financial Services Authority

Emil Levendoglu, HM Treasury

Sean McGovern, Lloyd's of London

Gabriel Moss QC, 3-4 South Square

Sir James Munby, The Law Commission

Ed Murray, Allen & Overy LLP

Steve Smart

Director: Joanna Perkins, Bank of England

---

35 Note that Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.