Volume 7 – Part 1 – 2018 ISSN 2050-9014

LAW AND ECONOMICS YEARLY REVIEW

ISSUES ON FINANCIAL MARKET REGULATION, BUSINESS DEVELOPMENT AND GOVERNMENT'S POLICIES ON GLOBALIZATION

Editors

F. CAPRIGLIONE – R. M. LASTRA – R. MCCORMICK
C. PAULUS – L. REICHLIN – M. SAKURAMOTO

FONDAZIONE CAPRIGLIONE Onlus *in association with* Queen Mary University of London

LAW AND ECONOMICS YEARLY REVIEW

www.laweconomicsyearlyreview.org.uk

Mission

The "Law and Economics Yearly Review" is an academic journal to promote a legal and economic debate. It is published twice annually (Part I and Part II), by the Fondazione Gerardo Capriglione Onlus (an organization aimed to promote and develop the research activity on financial regulation) in association with Queen Mary University of London. The journal faces questions about development issues and other several matters related to the international context, originated by globalization. Delays in political actions, limits of certain Government's policies, business development constraints and the "sovereign debt crisis" are some aims of our studies. The global financial and economic crisis is analysed in its controversial perspectives; the same approach qualifies the research of possible remedies to override this period of progressive capitalism's turbulences and to promote a sustainable retrieval.

Address

Fondazione Gerardo Capriglione Onlus

c/o Centre for Commercial Law

Studies Queen Mary, University of

London 67-69 Lincoln's Inn Fields

London, WC2A 3JB

United Kingdom

Main Contact

Fondazione G. Capriglione Onlus - fondazionecapriglione@luiss.it

ISSN 2050- 9014

Review Process

1. Articles and case notes submitted to the Review will be reviewed by at least two reviewers (chosen among the Editorial Board members) and, where necessary, by an external advisor.

2. Any paper will be submitted by the Editorial Board – anonymously, together with an evaluation form – to the reviewers for an overall assessment.

3. In case of a single negative evaluation by one of the reviewers, the Editor-in-chief may assume the responsibility to publish the paper having regard to highlight this circumstance.

4. In any case, the submission of the paper or its positive evaluation does not provide any right to the author to ask for the publication of the paper. Fondazione Gerardo Capriglione Onlus may reproduce articles published in this Review in any form and in any other publications.

CONTENTS

FOCUS ON GLOBAL PERSPECTIVES

PRESENTATION

1. The global, European and national size of economy gives rise to further thought on the ongoing validity of the key elements of the “Law and Economics”, highlighted by the analysis concerning the financial system and by the studies which examine the significant legislative changes occurred, especially in the last decade.

The ways in which the relationship between market operators have been taking place until recently show a situation that, for different reasons, marks an irreversible process of change compared to the past. The effects of such process, also from the social and political perspective, are not well defined yet and, therefore, appear worth of further investigation.

Therefore, the complex reality resulting from the well-known crisis of 2007 and following years still attracts the interests of the academic research. The latter must continue to offer adequate support in identifying the necessary measures to solve the many challenges raised by the amendments of the previous regulation. This, in view of avoiding that the dystonic elements of an unsuccessful process – due to the lack of validity of certain corrective actions of financial and economic nature – shift in the determination of innovative organizational formulas of the social and political models of reference.

2 Indeed, the difficulty of aligning the governance of prudential policies, granted to the relevant Authorities, with the stability of the financial system had to deal with the negative implications deriving from a relational change which took place among market operators. The regulatory framework, recently adopted by the EU, often failed to face and overcome these critical issues; it has not been possible to provide for an appropriate trade-off between innovation and stability. From such circumstance derive uncertainties which are reflected on the balance of

the economic and financial system.

It follows that the debate should still be focused on the in-depth study of the discipline on banking crises which, during the first years of application, has certainly represented one of the most significant aspects of the afore-mentioned regulatory complexity. In this context, the comparison with countries such as Japan, characterized by traditions and legal culture which are very different from the European one, may help.

Similarly, shall be deemed actual the questions concerning either the perspective of reform of the institutional architecture of the EMU, aimed at promoting a deeper integration of the economic policy and governance, or the possible scenarios relating to the UK financial services sector after Brexit, exploring in detail the case of credit rating agencies (CRAs) and the relations with the European Banking Union. Both these analysis profiles are intended to overcome differences and opposite points of view, highlighting the contradictions which still characterize the matters under investigation.

Moreover, with reference to the institutional architecture of the economic governance of the EU, specific importance shall be granted to the issues relating to the completion of the European Banking Union and the so-called "deepening" of the Economic and Monetary Union. It is an ambitious project which shall be critically scrutinized by underlining the existing relationship between EMU and the EBU and the need to jointly address the existing gaps.

Finally, it should be kept into account that "Law and Economics" studies show an increasing interest for the FinTech phenomenon, concerning companies which use technology-based systems in order either to directly provide financial services and products, or to make them more efficient. The research should clarify some uncertainties regarding the discipline of the matter, given that the imposition of "compliance obligations" implies increasing costs (which could represent an obstacle to the innovation and the creation of workplaces).

It is self-evident that the continuous development of the "Law and Economics" requires a continuous analysis to ensure the adequacy of the regulatory framework to create homogeneous forms of recovery of the European financial and economic system. This is the case of those Countries which, burdened for years by an austerity regime (which is accompanied by unemployment and a general sense of indignation of the civil society), are now exposed to the danger of a growing trend towards "populism", which distrusts the regulatory framework, originated as a reaction to the financial crisis.

Francesco Capriglione

Editor-in-Chief

CURRENT BASIC LINES OF THE DISCIPLINE OF BANK CRISES AND UNRESOLVED PROBLEMS: AN INITIAL COMPARISON BETWEEN THE SOLUTIONS ACCEPTED IN THE EUROPEAN UNION (WITH SPECIAL EMPHASIS ON ITALY) AND IN JAPAN, BETWEEN THE ROLE OF BANKING AUTHORITIES AND THE POWERS OF JUDICIAL AUTHORITY *

Masaki Sakuramoto** - Alberto Urbani***

ABSTRACT: *In The European Union, the current guidelines for bank crises summarized in the EU directive No. 2014/59/UE seems to have been built around three basic lines: the consequences of the crisis shall be primarily borne by the failed bank's shareholders and by its creditors, and only secondly by the community; it is appropriate to widen the tools available to the authorities in the field to govern a bank crisis; from this point of view, in particular, it is necessary to reinforce the early intervention protections and the recovery measures, in order to prevent the worsening of the bank's financial difficulty. This article intends to carry out an initial comparison between the EU guidelines and the fundamental principles governing the bank crisis in Japan, focusing on the powers granted to the supervisory authorities in the European Union and to the judicial powers in the Asiatic country.*

*Although this paper is the result of a joint reflection of the Authors, Masaki Sakuramoto is primarily responsible for paragraphs from 6 to 8, whereas Alberto Urbani is primarily responsible for paragraphs from 1 to 4; paragraph 5 is co-authored.

**Full Professor of Bankruptcy Law at Toyo University in Tokyo, Faculty of Law, sakuramoto@toyo.jp.

***Full Professor of Banking Law at Ca' Foscari University of Venice, Department of Economics, albeurba@unive.it.

stitutions» and definition of terms used therein. – 7. Bankruptcy proceedings of banks. – 7.1. Bankruptcy capacity. – 7.2. Cause of bankruptcy. – 7.3. Non-existence of bankruptcy barrier. – 8. Conclusion.

1. In the latest years, as is well known, the Italian banking system had to face some bank crises of a certain size and, most of all, having significant impact for the areas where such banks were mostly established; some of these crises have luckily been contained while at their initial stage, other ones instead were unfortunately concluded with the bank leaving the market. Among the most serious instances we shall absolutely remember, in 2015, the affairs of the so-called "four banks" (Banca delle Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, Cassa di Risparmio della Provincia di Chieti), placed under extraordinary administration at first and then under resolution, and later the two main Venetian ex mutual cooperative banks *default* (Banca Popolare di Vicenza and Veneto Banca), against which in 2017 a compulsory administrative banks liquidation was ordered; other cases of serious pathology, however, have been added concerning local small-sized banks, all having corporate form of credit union.

These crises events happened in reality at a very particular moment, not only due to the International economic crisis context that lasted, although through alternating stages, since 2008 and through which the whole global banking system had, to a greater or lesser extent, deal with, but also for having manifested right when the complex reform of the banks crises guidelines was coming into effect out of the implementation of the *Bank Recovery and Resolution Directive* (BRRD) No. 2014/59/UE. In Italy, this Directive has been completed with law decrees dated 16 November 2015, No. 180 and 16 November 2015, No. 181, the former forming an independent set of rules while the latter amending the provisions of the Consolidated text of the banking and credit laws (Law Decree dated 1 September 1993, No. 385). The Italian Credit Authorities, therefore, found themselves to be in the position, totally new for them and not just for them, not only to have to manage almost simultaneously the crises of many banks, some of which having significant size, but mostly to have to do so in a set of rules that had deeply changed recently, for the first time experimenting tools until then unknown to the national legislation and most of all not easy to be coordinated with some general principles of the domestic legal framework[1].

A further objective element of difficulty derived from the fact that, as it is well known, with the emergence of the Banking Union the supervision on the single banking companies is no longer entrusted to the authorities of the Member State of origin of the body, since this was generally "centralized" at the European Central Bank and the same thing can be said, in parallel, for what concerns the Single Bank Resolution Mechanism in case of a credit institution crisis. The ECB itself, however, inevitably has yet to consolidate its own supervisory and governance practices for the disruption situations of banking operators, so the dialogue and exchanges between the various public authorities involved (including the European Commission itself, for the aspects relating to the protection of economic competition)[2] often turned out to be complex and, quite frankly, not so easy and proactive as the urgency and the sensitivity of the issues to be addressed would have required.

It shall also be taken into account that some basic principles and many of the new rules that concern the management of bank crises are the subjects of heated debates among the bank's public supervision authorities themselves, among academics and practitioners, and at political level too[3]. Just think about, for example, the new *bail in* policy, on which most people agree theoretically but that, when its concrete implementation is necessary, gives rise to much controversy and reasonable grounds of perplexity[4]: if in fact, in theory, it would seem

---

[1]On this point, see the considerations of CAPRIGLIONE, *Crisi a confronto (1929 e 2009). Il caso italiano*, Padua, 2009.

[2]See, *e.g.*, ROSSANO, *Gli aiuti di Stato alle banche e le ritrattazioni della Commissione: tra distorsioni della concorrenza e (in)stabilità finanziaria*, in *Riv. trim. dir. econ.*, 2016, II, p. 1 ss.

[3]On this point see also CAPRIGLIONE, *Regolazione europea post-crisi e prospettive di ricerca del diritto dell'economia: il difficile equilibrio tra economia e finanza*, in *Riv. trim. dir. proc. civ.*, 2016, p. 537 ss.

[4]See, *e.g.*, AVGOULEAS and GOODHART, *Critical Reflections on Bank Bail-ins*, in *Journal of Financial Regulation*, 2015, 1, pp. 329; BOCCUZZI and DE LISA, *Does Bail-in Definitely Rule*

reasonable to choose to impose the effects of a bank crisis, as an undertaking, primarily to the shareholders, that is to those holding the share capital of the bank, however, in practice this choice can prove to be unfair and detrimental for all those small shareholders that do not have adequate know-how and skills to monitor and understand the real state of health of the bank and, most of all, the risks they will have to face.

As a consequence, a debate started not just in Italy but also at the European Union level, concerning the opportunity to re-examine some of the rules introduced in 2014 with BRRD: in the intentions, it shouldn't be to subvert all the systems of the provisions that have recently been introduced, but to implement targeted interventions that, even paying particular attention to the first experiences, may also be able to mitigate some consequences of the new rules that objectively appeared too harsh to the detriment of less aware investors[5]. The risk is, on the other hand, to compromise the trust of a wider audience less experienced with regards to either a single bank or the banking system as a whole. This is a risk that is just as serious and dangerous – therefore to avoid– because, by definition, it tends to manifest itself in a virulent manner when the pathology tends to prevail on the banking relationships physiology.

2. Especially when it is assumed to modify the rules in force due to their limits and criticalities, the comparison between the experiences of different coun-

---

out Bailout?, in *Journal of Financial Management, Markets and Institutions*, Issue 1, 2017, pp. 93-100; BABIS, *Bank Recovery and Resolution: What About Shareholder Rights?*, University of Cambridge Faculty of Law Research Paper No. 23/2012, available at SSRN: *https://ssrn.com/abstract=2144753*; TRÖGER, *Too Complex to Work: A Critical Assessment of the Bail-in Tool under the European Bank Recovery and Resolution Regime*, in *Journal of Financial Regulation*, Vol. 4, Issue 1, pp. 3572; GOODHART and AVGOULEAS, *A Critical Evaluation on Bail-ins as Bank Recapitalisation Mechanism*, Centre for Economic Policy Research, Discussion Paper 10065, 2014; PERSAUD, *Why Bail-in Securities Are Fool's Gold'*, *Policy Brief*, Peterson Institute for International Economics, November 2014; HADJIEMMANUIL, *Limits on State-funded bailouts in the EU Bank Resolution regime*, in *European Economy*, 2/2016; HÜSER, HALAJ, KOK, PERALES and VAN DER KRAAIJ, *The systemic Implications of Bail-in: A Multi Layered Network Approach'*, Working Paper Series 2010,European Central Bank, 2017.

[5]See EUROPEAN PARLIAMENTARY RESEARCH SERVICE, *Amending the bank resolution framework – BRRD and SRMR*, 2017.

tries and, consequently, of different legal systems is not just interesting, but many times can turn out to be fruitful.

Starting from these basic considerations and taking into account what mentioned before, we have deemed that, in the following pages, it would be interesting compare some guidelines relative to the regulations of the management of banking crises in the EU (and, of course, in Italy) as well as in Japan. The chance was offered by the presence at Venice, as *visiting professor* for one year at the University Ca' Foscari, of one of us, Masaki Sakuramoto, who, in his capacity of Bankruptcy Law Scholar, has had a chance to dialogue upon these topics with the other one, Alberto Urbani, that is Professor of Banking Law at the above-mentioned University. The following considerations represent the results of the first dialogue between two persons that are very different both for their own field of research. This is a dialogue that we hope to be able to better develop and deepen in the next future.

Now, starting from the European Union guidelines and in particular from the Italian one related to the management of bank crises, it seems to us that the layout of the rules launched in 2014 is essentially based on three basic ideas.

The first one, which we have fleetingly mentioned in the introduction, is that the negative effects of a bank crisis shall weight as far as possible on the credit institution shareholders and secondly, although within certain limits and with various precautions, on its creditors[6]. A public intervention to support a bank facing difficulties is therefore conceived as a somehow dystonic moment if compared to the general regulations, and so as an exceptional one[7]. As a consequence, we witness a coherent approach to one of the most consolidated methods of the European banking laws, that is the inherently entrepreneurial character of the banking activity. Since a bank is essentially an undertaking, it shall face all the risks

[6]On the general principles governing the treatment of creditors under the BRRD see BINDER, *The Position of Creditors Under the BRRD. Commemorative Volume in memory of Professor Dr. Leonidas Georgakopoulos*, Bank of Greece's Center for Culture, Research and Documentation, 2016, pp. 37-61, available at SSRN: *https://ssrn.com/abstract=2698086*.

[7]On this point, see more in details BRESCIA MORRA, *Nuove regole per la gestione delle crisi bancarie: risparmiatori vs contribuenti*, in *Analisi giur. dell'econ.*, 2016, p. 279 ss.

connected to any economic undertaking of the same kind, including the possibility of an adverse outcome of its entrepreneurial activity, up to the point that serious, difficult conditions may happen and, on occasion, have exceptional seriousness.

Now, who bears the business risk enshrined in the activity of any bank? If you take into account the fact that any credit institution not only represents the interests of the shareholders and mostly of the more or less wide class of customers, it will also favour, downhill, the development of a close network of economic relationships between the single customer and a plurality of other entities, it will be clear that the management of a bank crisis also underlies a very significant public interest: hence the need to not *a priori* exclude the opportunity of a public intervention not only to govern in terms of supervisory work the existing crisis, but also in order to transfer (at least partially) to the community the adverse economic consequences. Schematizing and so simplifying as close as possible the approach to this problem, we could place the issue in terms of an alternative: either choosing to shift the burden of the crisis on the direct interlocutors of the bank or, on the contrary, bailing it out on the whole community through the general taxation system; obviously intermediate solutions cannot be excluded, that is searching for a balance point between these two basic choices.

Consistent with the undertaking nature of the banking activity, effective from the BRRD the European Union expressed its strong preference towards the first solution. To get a confirmation, without analysing in detail the single provisions of the directive, it will be sufficient to read some *recitals*: in particular *Recital* 67, where it is written that «*An effective resolution regime should minimise the costs of the resolution of a failing institution borne by the taxpayers*», ensuring that «*systemic institutions can be resolved without jeopardising financial stability*» in general; or *Recital* 8, for which «*Resolution of an institution which maintains it as a going concern may (…) involve government financial stabilisation tools, including temporary public ownership*», but this, expressly, only «*as a last resort*»; or again *Recital* 5, where it requires that «*The regime should ensure that sharehold-*

ers bear losses first and that creditors bear losses after shareholders, provided that no creditor incurs greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings in accordance with the no creditor worse off principle as specified in this Directive». It is true that in the BRRD this latter clause has a central role, so much so that further on, in *Recital* 46, it is added that «*The winding up of a failing institution through normal insolvency proceedings should always be considered before resolution tools are applied*», but also, in turn, that

«*the resolution tools should be applied before any public sector injection of capital or equivalent extraordinary public financial support to an institution*» (*Recital* 55). In short, therefore, if the crisis of a bank would be deemed to be particularly serious by the sector authority, the directive 2014/59/UE prefigures an approach that favour such bank to leave the market (through its "liquidation," very often in the form of compulsory administrative liquidation, like in Italy) and that just secondly will opt for one "resolution" tool, taking a possible public financial support just as the latter component of a global broader strategic plan, especially through the subscription of capital increase[8]. On the other hand, as it is well known, the compulsory liquidation of a bank can produce, at least with regards to the creditors, less penalizing effects compared to some resolution tools.

Therefore, according to the current way to govern bank crises in the European Union the entrepreneurial nature of the banking activity and the related competitive dynamics impose that the privileged way for resolving the irreversible crisis of a bank would be its removal from the market, through its liquidation, or to the maximum extent through severe resolution mechanisms, while the forms of collectivisation of the losses have to be considered absolutely exceptional.

In other terms, it is clear that the current guidelines are not focused on pre-

[8]On the relationship between these three stages of the authorities intervention in case of banking crisis, in the Italian scholarship see INZITARI, *BRRD, bail in, risoluzione della banca in dissesto, condivisione concorsuale delle perdite (d.lgs. 180/2015)*, in *Riv. dir. banc*., 2016, n. 5, in *dirittobancario.it*; STANGHELLINI, *Risoluzione, bail in e liquidazione coatta: il processo decisionale*, in *Analisi giur. dell'econ*., 2016, p. 567 ss.

serving the banking institution, but instead only to safeguard its *functions*: already the *Recital* 1 of the Directive won't leave any degree of doubt about that.

3. A second option, very evident, from the European legislator, consists of making available to public authorities a broad range of tools to combat the crisis of a bank. This is made clear ever since in *Recital* 5 of the Directive, at the point where it's pointed out that «*A regime is therefore needed to provide authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system»*[9].

We are in front of a highly significant suggestion, which demonstrates, at first, the effort to combine in this delicate matter a plurality of intentions (this way openly denying the conviction, quite prevalent among common people, that the current guidelines are focused on the fortunes of a intermediary experiencing difficulties leaving merely in the background any consideration on the implications of the crisis on the economy and on the financial system as a whole); at second, the effort to favour a coordinated deployment of response measures of various nature and degree of intensity, starting from the ones aiming at overcome a situation of difficulty at its early stage (*e.g.* resolution plans) in order to land at the other extreme of those usable in case of a very serious and full-blown crisis. In this context a long line of preventive and preparatory measures, of infra-group financial support, of early intervention and of resolution fit in (in particular, the transfer of business activities, the establishment of a bridge institution, *bail-in*).

It is clear that such a choice would consequently involve the Authorities, equipped by the legislator with «*the appropriate use of the margin of discretion*» in selecting one or another tool or, more often, in combining together more than

[9]See, *e.g.*, KLEFTOURI, *European Union Bank Resolution Framework: can the objective of financial stability ensure consistency in resolution authorities' decisions?*, in *ERA Forum*, 2017, vol. 18, pp. 263-279, 278 (noting that «it is necessary for the resolution authorities to have sufficient flexibility to be in a position to effect an orderly resolution as quickly as is necessary»).

one, as acknowledged by *Recital* 89 of the Directive; rather, even, a bit before *Recital* 85 clearly states that «*It is not necessary to prescribe the exact means through which the resolution authorities should intervene in the failing institution*».

Hence, however, two questions arise. First of all, we may wonder if and to which extent such a discretion would keep being consistent with the entrepreneurial nature of the banking activity according to the first basic idea of the European regulation that we have outlined above: also out of the drive from the many "external" requests to the bank in crisis we mentioned before, there is still a concrete risk that the public authorities be tempted to go back to forms of structural supervision that we thought to have definitely abandoned, at least starting from the Second directive of bank harmonisation of 1989. Secondly, sometimes we have the impression that the tools made available by the authorities are even more than they should, to the extent of having sometimes being replicated in several points without an effective need and with variants that are not so crucial[10]: just think of the powers to remove corporate representatives that also as a result of the so-called CRD IV (*Capital Requirement Directive*) No. 2013/36/UE are variously set either in the presence of an *in bonus* bank and in the event of the organisation is in crisis. *Entia non sunt multiplicanda sine necessitate*: are we sure that in this occasion the supranational legislator did properly take it into account?

4. The third and last guideline of the European discipline of banks crises, finally, constitutes basically a corollary of the previous one. Within a perspective that we can entirely consider shareable, in fact, the current provisions concerning the bank's crisis dedicates to the first intervention measures – that is when the crisis is still showing to be in its early stage and without connotations of particular

[10]For a critical assessment, see, recently, CIRAOLO, *Il finanziamento «esterno» delle risoluzioni bancarie tra tecniche normative e diritto vivente*, Padua, 2018, p. 112 ss.

seriousness – an attention rather unknown before[11]. In this regard, the Preamble to the BRRD is clear and emblematic, especially when it points out, at *Recital* 40, that «*In order to preserve financial stability, it is important that competent authorities are able to remedy the deterioration of an institution's financial and economic situation before that institution reaches a point at which authorities have no other alternative than to resolve it. To that end, competent authorities should be granted early intervention powers, including the power to appoint a temporary administrator, either to replace or to temporarily work with the management body and senior management of an institution*». It is evident the assumption at the back that tools of this type could create a very important stronghold to avoid, or at least reduce, the chance that the bank's crises could become irreversible[12].

Concretely, besides recovery and resolution plans, they detect the tools referred at the III Title of the directive, that is the ones provided for by articles 27-30, which start from the request that the supervisory authorities could impose the administrative body of the bank in trouble to implement one or more of the measures specified in the recovery plan and that, following the request to call a meeting and/or remove one or more of the representatives deemed unfit to manage the bank, could lead to the administrative removal of such representatives and, if necessary, to their temporary replacement (but at times more simply to their temporary tutoring) with a temporary administrator.

From this point of view, the Italian banking system could luckily count on the long-standing years of application experience of extraordinary administration, an institution still provided for by the banking act dated 1936-38 and later replicated with few amendments in the Banking Consolidated Text dated 1993[13]. The

[11]For all, see HUERTAS-NIETO, *A game changer: The EU banking recovery and resolution directive*, 2013, in *voxeu.org*; SUPINO, *Soggettività bancaria, assetti patrimoniali, regole prudenziali*, Milan, 2017, p. 91.

[12]See SCHILLING, *Bank Resolution Regimes in Europe: Recovery and Resolution Planning, Early Intervention, Resolution Tools and Powers*, in *Eur. Bus. Law Rev*., 2013, vol. 23, n. 6, p. 751 ss.; PELLEGRINI, *Piani di risanamento e misure di* early intervention, in *federalismi.it*, 2018, n. 2.

[13]On the previous guidelines, see BOCCUZZI, *Le procedure di amministrazione straordinaria e di liquidazione coatta amministrativa: i presupposti soggettivi e oggettivi*, in *La crisi dell'impresa*

Italian legislator had to implement the EU provisions concerning early intervention measures by introducing norms previously not provided for in the national legislation (articles 69-*octiesdecies*—69-*vicies-bis* t.u.b.), but – concerning the disqualification of the bank corporate bodies and their temporary replacement with others directly appointed by the supervisory authorities – he could take advantage of the discipline of the extraordinary administration, so that it has been able to limit itself to rather marginal corrective actions.

This does not, however, mean that, with the reform, the extraordinary administration had in fact not changed its connotation from the systematic standpoint. Before the 2015 reform, indeed, it was part of a Title expressly dedicated to the "*Management of the crises*" and was seen as a tool finalized to manage a bank crisis that was serious, but not to the extent to be deemed irreversible, so much so that the desired solution of the procedure (unfortunately not always achieved) was the return of the bank to the ordinary management. If we look at the requirements that can lead to its adoption and to the procedure effects, apparently things have not changed today. However, considering better the changes at the back, they are quite significant, in so far as the above-mentioned Title, which continues to regulate the extraordinary administration, has been completely amended and now is no longer referring to the "crisis" of the intermediary; on the contrary, the extraordinary administration has been incorporated in the list of the "restoration processes" (cfr. art. 69-*bis*, point *f)*, t.u.b.), a fact that emphasises its innovative position[14] that, in an ideal range in terms of seriousness of the crisis and therefore of the incisiveness of the intervention measures, see such procedure laid down a step higher than the preparatory and early intervention

---

bancaria. Profili economici e giuridici, a cura di Boccuzzi, Milan, 1998, partic. p. 147 ss. and especially, right before the reform, ID., *Towards a new framework for banking crisis management. The International debate and the Italian model*, in *Quaderni di ricerca giuridica* of Bank of Italy Legal Advice, n. 71, Roma, october 2011.

[14]See CAPRIGLIONE-SUPINO, *Comment* sub *art. 70*, in *Commentario al testo unico delle leggi in materia bancaria e creditizia*, ed. by Capriglione, 4th ed., Padua, 2018, p. 996 ss.

measures, but before the resolution tools[15].

Only time will tell us if and to which extent this wide instrumentation of "prompt intervention" measures available to the authorities in the face of the emergence of a banking crisis will effectively be able to prevent further deterioration of the situation of the institution facing financial difficulties.

5. Let's consider now the Japanese legislation, the figure that emerges from the main law that governs the banking crises in the Asiatic country (Law N. 95 of 21 June 1996) is substantially similar to the European Union one.

Even with regards to the three guidelines mentioned and summarized above, we can say that even in Japan the banking activity is codified as a business activity and consequently if the bank has become insolvent, a *lato sensu* bankruptcy proceedings is commenced. However, differently from Europe, the State intervention to support the banks in trouble is everything but residual.

It is instead possible to observe a full correspondence between the two legislations for what concerns the plurality of tools available to the authorities in the field to manage the collapse of a credit institution and also a more specific reference to the early intervention tools.

Having said this, it is, however, proper to immediately add that even if, like in Europe, in Japan the bank crises are managed under the aegis of the supervisory authorities, nevertheless the judicial authority performs a very important role in the Asiatic country. For this reason, after a short introduction to the Japan guidelines to the banking crises, we have deemed interesting to focus, albeit briefly, on the managing of the bank's crises not so much from the standpoint of the banking legislation, but rather of the bankruptcy laws.

The bankruptcy proceedings of banks in Japan are regulated by the *Act on Special Measures for the Reorganization Proceedings of Financial Institutions* (Act

---

[15]It wishes that consequently, even public authorities would adopt one or the other tool taking into account the different degree of intensity of the crisis CASTIELLO D'ANTONIO, *L'amministrazione straordinaria delle banche nel nuovo quadro normativo. Profili sistematici*, in *Analisi giur. dell'econ*., 2016, p. 557 ss.

No. 95 of 1996) (hereinafter referred to as the "*Special Measures Act*")"[16] and the *Bankruptcy Act* (Act No. 75 of 2004). When a bank becomes bankrupt, since the Special Measures Act is an act that prescribes the special provisions on the bankruptcy proceedings of banks, matters that are not prescribed in the Special Measures Act as special provisions are subject to the application of the Bankruptcy Act[17].

In this paper, the overview and terms of the Special Measures Act will be explained in Chapter 6, and the conditions for commencing the bankruptcy proceedings of Japanese banks will be explained in Chapter 7 (7.1 Bankruptcy capacity, 7.2 Grounds for commencement of bankruptcy proceedings, 7.3 Non-existence of bankruptcy barrier)[18].

Incidentally, because the Special Measures Act does not target banks having their head office in a foreign country, such banks are also excluded from this paper.

6. Before the burst of the bubble economy, even if a bank were to fail, the plan was to proceed with the insolvency proceedings by applying standard insolvency laws such as the Bankruptcy Act[19]. Nevertheless, after the burst of the bubble economy, many financial institutions, including banks, went insolvent, and the necessity of legislation and law revisions was felt keenly. The Special Measures Act was enacted as one of the series of relevant laws to deal with the foregoing situa-

[16]While the law number is indicated in the era name in Japan, the western calendar is used in this paper for the convenience of readers.

[17]See UCHIBORI and KAWABATA, *Overview of Reorganization Proceedings, etc. of Financial Institutions (Part 1)*, in *NBL*, 1997, n. 612, p. 25. N.B., all the documents cited in my part are written in Japanese.

[18]While the affairs performed by the Financial Administrator against financial institutions including banks and injunctions of the Prime Minister ordering the management of property (Deposit Insurance Act, Article 74 onward) or the measures against a financial crisis taken by the Prime Minister (Measures Under Item (ii), Measures Under Item (iii) (Deposit Insurance Act, Article 102, Paragraph 1, Item (2), Item (3)) may correspond to measures against banks subject to grounds for commencement of bankruptcy proceedings, they are not referenced herein because they are not judicial proceedings.

[19]See ITO, *Laws Concerning Insolvency Proceedings of Financial Institutions*, in *Course: System of Insolvency Laws (4th volume)*, eds. by TAKAGI and ITO, Tōkyō, 2006, p. 258.

tion[20].

Article 1 of the Special Measures Act prescribes as follows: «*The purpose of this Act is to enable smooth progress of reorganization proceedings, rehabilitation proceedings, and bankruptcy proceedings in financial institution or similar entity while ensuring that the rights of depositors and similar creditors are fulfilled, by, inter alia, providing for the necessary particulars concerning the reorganization proceedings of cooperative financial institutions and mutual companies so as to enable them to reorganize and remain in business while coordinating the interests of interested persons; by providing for the necessary particulars concerning Supervisory Agency petitions for reorganization proceedings, rehabilitation proceedings, and bankruptcy proceedings in financial institutions or similar entity; and by providing for the necessary particulars concerning actions within the scope of these processes that the Deposit Insurance Corporation of Japan and others undertake for and on behalf of depositors and similar creditors*» and aims to ensure the realization of rights of depositors, etc. and seek the smooth promotion of procedures in (corporate) reorganization proceedings, (civil) rehabilitation proceedings and bankruptcy proceedings of financial institutions and similar entities, including banks. This Act not only prescribes the special provisions of the Bankruptcy Act, it also prescribes the special provisions of the Civil Rehabilitation Act (Act No. 225 of 1999) and the Corporate Reorganization Act (Act No. 154 of 2002). Accordingly, this Act prescribes the special provisions of laws that regulate the basic matters of the insolvency law system regarding corporations that are at the core of the Japanese economy[21].

The definition of terms is now explained. First, the term «*financial institution or similar entity*» means a foreign bank in relation to a foreign bank branch, bank holding company, long-term credit bank holding company, federation of

[20]See YOSHIKAI, *Consideration of Legal Issues of Laws Related to Failed Financial Institutions (Part 1)*, in *Shōjihōmu,* 1999, n. 1531, pp. 4-5.
[21]Generally speaking, when the term «insolvency laws» is used in Japan, special liquidation is included in addition to these laws (Companies Act (Act No. 86 of 2005) articles 510 - 574, 879 - 902).

Shinkin Banks, federation of credit cooperatives, federation of labor banks, financial instruments business operator, designated parent company, insurance company, insurance holding company insurance company, or small amount and short term insurance provider (Special Measures Act, Article 490) (however, this is the definition of a financial institution or similar entity for which the supervisory agency may file a petition for commencement of bankruptcy proceedings[22]). The term «*financial institution*» means a bank, cooperative financial institution, or the Shoko Chukin Bank Limited (Special Measures Act, Article 2, Paragraph 3), and the term «*cooperative financial institution*» means a credit cooperative, Shinkin Bank, or labor bank (Special Measures Act, Article 2, Paragraph 2).

The term «*bank*» refers to the bank defined in Article 2, Paragraph 1 of the Banking Act (Act No. 59 of 1981) and the long-term credit bank defined in Article 2 of the Long-Term Credit Bank Act (Act No. 187 of 1952). The term «*bank*» defined in Article 2, Paragraph 1 of the Banking Act means a person who engages in banking under the license from the Prime Minister, and the term «*banking*» means (1) acceptance of deposits or installment savings, as well as the lending of funds or the discounting of bills and notes, and (2) dealing in funds transfer transactions (Banking Act, Article 2, Paragraph 2). Furthermore, a bank must be a stock company (Banking Act, Article 4-2).

7.1 Here, I mention first persons who may file a petition for commencement of bankruptcy proceedings , and then the bankruptcy capacity is subsequently explained. First, a person who may file a petition for commencement of bankruptcy proceedings under the Bankruptcy Act is, generally speaking, a creditor or a debtor (Bankruptcy Act, Article 18), and, in addition, a director *(riji 理事)* of a general incorporated association or general incorporated foundation or a di-

---

[22]The definition of «*financial institution or similar entity*» for which the supervisory agency may file a petition to commence reorganization proceedings is prescribed in Article 377 of the Special Measures Act, and, similarly, the definition of «*financial institution or similar entity*» for which the supervisory agency may file a petition to commence rehabilitation proceedings is prescribed in Article 446 of the Special Measures Act.

rector *(torishimariyaku 取締役)* of a stock company or mutual company may file a petition for commencement of bankruptcy proceedings under his/her status (Bankruptcy Act, Article 19). When this is applied to a bank, a depositor as an individual creditor (there is no criteria of the minimum claim amount for the petition to be approved) may file the petition, a bank as a stock company may independently file the petition (this is referred to as «*voluntary bankruptcy*» in this case), and a director of a bank may file the petition under his/her own individual qualification (this is referred to as «*semi-voluntary bankruptcy*» in this case). Furthermore, under the Special Measures Act, the Prime Minister as the supervisory agency (delegated to the Commissioner of the Financial Services Agency pursuant to Article 548 of the Special Measures Act) may file a petition for commencement of bankruptcy proceedings against a bank (Special Measures Act, Article 2, Paragraph 9, Item (1), Article 490, Paragraph 1). The reason for this is considered to be because it is difficult for individual depositors to comprehend the financial condition of banks, and, because it cannot be expected that a petition for commencement of bankruptcy proceedings will be filed in a timely manner, the authority to file the petition was granted to the supervisory agency which possesses information concerning the status of property and which is capable of determining, from a technical perspective, whether the filing of such a petition is necessary[23]. When the supervisory agency is to file a petition for commencement of bankruptcy proceedings, it is prescribed that, if «*the maintenance of an orderly credit system may be materially affected if it files a petition to commence bankruptcy proceedings*», the supervisory agency must consult in advance with the Minister of Finance on measures necessary for the maintenance of an orderly credit system (Special Measures Act, Article 490, Paragraph 2, Article 377, Paragraph 2).

Next, with regard to the target of bankruptcy[24]; that is, the bankruptcy ca-

[23]See MIYAMA, *Financial Institutions and Bankruptcy*, in *Bankruptcy Act System (3rd volume)*, eds. by TAKESHITA and FUJITA, Tōkyō, 2015, p. 434.
[24]Bankruptcy capacity is also acknowledged for inherited property and trust property. The petitioner in these cases is prescribed in Article 224, Paragraph 1 and Article 244-4, Paragraph 1 of the Bankruptcy Act.

pacity of whether a person is qualified to become bankrupt under the bankruptcy proceedings, in Japan which adopts the general bankruptcy principle *(ippanjin hasan shugi 一般人破産主義)*, in addition to individuals (including foreign individuals), corporations (while all private corporations such as stock companies are affirmed, the national government and local governments are denied on grounds of being primary governing institutions, and there are disputes concerning special corporations and public partnerships) also have bankruptcy capacity, and, because a bank needs to be stock company as described above, there is no problem with respect to this point.

7.2. In the case of filing a petition for commencement of proceedings under the Bankruptcy Act, a bank must be «*unable to pay debts (Bankruptcy Act, Article 15, Paragraph 1)*» or *«insolvent (Bankruptcy Act, Article 16, Paragraph 1)»*. This is derived from the fact that a bank is a stock company (corporation). Meanwhile, in the case of filing a petition for commencement of proceedings under the Special Measures Act, the requirement is prescribed as «*when a fact constituting grounds for the commencement of bankruptcy proceedings has occurred (Article 490, Paragraph 1)*», and it is said that this condition is the same as the condition for filing a petition for commencement of proceedings under the Bankruptcy Act[25]. This is derived from the fact that a bank is a financial institution as referred to inū the Special Measures Act. In other words, regardless of whether the supervisory agency files the petition or a deposit creditor, etc. files the petition, the bank must be unable to pay debts or insolvent to constitute grounds for commencement of bankruptcy proceedings, and with respect to this point there is no difference between the Special Measures Act and the Bankruptcy Act.

Incidentally, with regard to the timing of determining the following grounds for commencement of bankruptcy proceedings, grounds for commencement of

[25]See UCHIBORI and KAWABATA, *Overview of Reorganization Proceedings, etc. Based on the Act on Special Measures for the Reorganization Proceedings of Financial Institutions (Part 1)*, in *Kinyūhōmujijyō*, 1997, n. 1478, p. 21.

bankruptcy proceedings need to exist at the time of trial of the bankruptcy case; that is, at the time of the first instance and the second instance. Accordingly, even if a cause of bankruptcy existed at the time that a petition for commencement of bankruptcy proceedings was filed, it such cause of bankruptcy no longer exists at the time of order of commencement, proceedings are not commenced, and, even if procedures are commenced on grounds that a cause of bankruptcy existed at the time of the first instance, the order of commencement of bankruptcy proceedings will be rescinded if such grounds for commencement of bankruptcy proceedings no longer exist at the time of the second instance[26].

In the ensuing explanation, «*unable to pay debts*» and «*insolvent*» will be discussed as the cause of bankruptcy, and, while it does not constitute a cause of bankruptcy, «*suspension of payment*» will also be discussed as an inference thereof.

7.2.1. The concept of «*unable to pay debts*» is defined in Article 2, Paragraph 11 of the Bankruptcy Act, and is prescribed as follows: «*the condition in which a debtor, due to the lack of ability to pay, is generally and continuously unable to pay his/her debts as they become due*». In other words, (i) the debtor lacks the ability to pay, (ii) the debtor is unable to promptly pay his/her debts as they become due, (iii) the debtor is generally and continuously unable to pay his/her debts, and (iv) the debtor's state of "unable to pay debts" is an objective state.

Foremost, «*(i) the debtor lacks the ability to pay*» is comprehensively determined based on property, credit and labor, and refers to a case where debts cannot be paid based on any of the above. Accordingly, even if a debtor does not own any property, the debtor's solvency will be affirmed if he/she is able to borrow money from others based on his/her credit and repay the debts. Neverthe-

[26]See, *e.g.*, OGAWA, *Comment in pp. 66-67, YOMORI Comment in p. 69,* in *Commentaries on the Bankruptcy Act,* ed. by TAKESHITA, Tōkyō, 2007; SUGIYAMA, *Comment in p. 48,* in *Commentaries on New Basic Laws - Bankruptcy Act,* eds. by YAMAMOTO et al., Tōkyō, 2014; ITO, *Bankruptcy Act / Civil Rehabilitation Act (3rd ed.),* Tōkyō, 2014, p.109; KOBAYASHI, *Comment in p.95,* in *Commentary on Bankruptcy Act (Part 1),* ed. by National Insolvency Lawyers Network, Tōkyō, 2015.

less, even if a debtor owns property, if it is difficult to convert such property into cash, then the debtor's solvency will be denied.

Next, «*(ii) the debtor is unable to promptly pay his/her debts as they become due*» refers to a case where debts have matured, but the debtor is unable to pay the debts in which the performance thereof was demanded by the creditor. Even if it is certain that a debtor will not be able to pay debts that will mature in the future, so as long as the debtor is paying debts that are currently due, it is deemed that such debtor is not in a state of «*unable to pay debts*».

Furthermore, with regard go «*(iii) the debtor is generally and continuously unable to pay his/her debts*», the term «*generally*» refers to a state where all or most of the debts cannot be paid, and it is not deemed that a debtor is «*unable to pay debts*» in a state where he/she is unable to pay only a part of the debts. Next, the term «*continuously*» refers to a state in which a debtor in unable to pay debts is ongoing, and it is not deemed that a debtor is «*unable to pay debts*» even if he/she discontinues payment as a result of temporarily falling short of funds.

Finally, «*(iv) the debtor's state of 'unable to pay debts' is an objective state*» refers to a case where, even if a debtor underestimates his/her solvency and suspends payment, it is not deemed that a debtor is «*unable to pay debts*» if such debtor objectively has sufficient funds[27]. If a bank is unable to pay debts, it means that there are grounds for commencement of bankruptcy proceedings, and the Prime Minister may file a petition for commencement of bankruptcy proceedings under the Special Measures Act, and a creditor (including a deposit creditor), the bank itself as the debtor, and a director of the bank as an individual may file a petition for commencement of bankruptcy proceedings under the Bankruptcy Act.

7.2.2 The concept of «*insolvent*» is prescribed in Article 16, Paragraph 1 of the Bankruptcy Act as «*the condition in which a debtor is unable to pay its debts in*

[27]For explanation of requirements of (i), (ii), (iii) and (iv), refer to TAKESHITA (ed.), *op. cit. (26)*, pp. 21-22; YAMAMOTO (eds.), *op. cit. (26)*, pp. 46-47; ITO et al., *Article-by-Article of Bankruptcy Act (2nd ed.)*, Tōkyō, 2014, pp. 41-42; ITO, *op. cit. (26)*, pp. 107-108.

full with its property». In other words, this refers to a state where the total amount of liabilities exceeds the total amount of assets[28]. The concept of «*insolvent*» differs from the concept of «*unable to pay debts*» with respect to the following points; namely, undue debts are also calculated, and only the debtor's property is used as a reference, and the debtor's credit and labor are not given consideration[29].

Here, how to evaluate the debtor's assets upon determining whether or not such debtor is insolvent becomes problematic.

Theories can be generally classified as follows [30]. (a) Theory that the debtor's assets should be evaluated based on the liquidation value as a result of disposing the debtor's business, (b) theory that the debtor's assets should be evaluated based on the going concern value on the assumption that the debtor's business is to be continued [31], (c) theory that the debtor's assets should be evaluated based on a higher value upon comparing (a) and (b) above [32], and (d) theory that the debtor's assets should be evaluated based on whether or not the debtor's business is ongoing; that is, based on the going concern value when the debtor's business is ongoing, and based on the liquidation value when the debtor's business has been discontinued [33].

When this is applied to determine whether a bank is insolvent, if the bank has already discontinued its business, etc., the property to become the creditor's security will be the liquidation value and, therefore, the bank's assets should be determined based on the liquidation value.

Meanwhile, if the bank is continuing its business, etc., because the creditor will receive payment solely from business profits when the going concern value

---

[28]See YAMAMOTO (eds.), *op. cit. (26)*, p. 49; ITO et al., *op. cit. (27)*, p. 126; ITO, *op. cit. (26)*, p. 113.

[29]See TAKESHITA (ed.), *op. cit. (26)*, p. 69; YAMAMOTO (eds.), *op. cit. (26)*, p. 49; ITO et al., *op. cit. (27)*, p. 126.

[30]For details of the theory, refer to YAMAMOTO (eds.), *op. cit. (26)*, p. 49; Network, *op. cit. (26)*, pp. 99-100.

[31]See TAKESHITA (ed.), *op. cit. (26)*, p. 69.

[32]See YAMAMOTO (eds.), *op. cit. (26)*, pp. 49-50; Network, *op. cit. (26)*, pp. 99-100.

[33]See ITO et al., *op. cit. (27)*, p. 128; ITO, *op. cit. (26)*, p. 115.

exceeds the liquidation value upon comparing the two, whether a bank is insolvent should be determined based on the going concern value.

Nevertheless, there may be a case where the bank is similarly continuing its business, etc., but the going concern value falls below the liquidation value.

For example, in cases where the bank is insolvent when determined based on the going concern value but not insolvent when determined based on the liquidation value, grounds for commencement of bankruptcy proceedings will be acknowledged when based on the going concern value, but an order of commencement of bankruptcy proceedings cannot be issued because the bank is not insolvent when based on the liquidation value.

In the foregoing case, which case would be more adequate for the bank?

Upon comparing a case where the bank is liquidated and a case where the bank continues its business, rather than intentionally liquidating the bank through bankruptcy proceedings, which would result in a state where the bank would be required to make distributions to creditors, preference should be given to continuing its business when giving comprehensive consideration to various factors including losses associated with liquidation and impact on society.

Accordingly, the theory that the debtor's assets should be evaluated based on higher value upon comparing the going concern value and the liquidation value would be valid[34].

7.2.3 The term «*suspension of payment*» refers to «*the debtor's act of externally indicating that, due to the lack of ability to pay, he/she is generally and continuously unable to pay his/her debts as they become due*»[35].

Nevertheless, the concept of «*suspension of payment*» is not a cause of bankruptcy, and has the following function: «*when a debtor has suspended payments, the debtor shall be presumed to be unable to pay debts*» under Article 15,

---

[34] See YAMAMOTO (eds.), *op. cit. (32)*; Network, *op. cit. (32)*.
[35] See TAKESHITA (ed.), *op. cit. (26)*, p. 67; YAMAMOTO (eds.), *op. cit. (26)*, p. 47; ITO, *op. cit. (26)*, p. 109; Network, *op. cit. (26)*, p. 96.

Paragraph 2 of the Bankruptcy Act.

As described above, if a bank is unable to pay debts, there will be grounds for commencement of bankruptcy proceedings, but because the concept of «*unable to pay debts*» is an objective fact and it is difficult to demonstrate the same directly, the Bankruptcy Act is attempting to infer the concept of «*unable to pay debts*» based on this «*suspension of payment*».

In other words, if a bank suspends the withdrawal of deposits, etc., it is inferred that the bank is unable to pay debts based on the foregoing fact unless the debtor (bank) disproves such suspension of payment or demonstrates that it is not in a state of «*unable to pay debts*», and grounds for commencement of bankruptcy proceedings are thereby acknowledged.

7.3 Where a petition for commencement of bankruptcy proceedings is filed and when it is found that there is a fact constituting the grounds for commencement of bankruptcy proceedings, an order of commencement of bankruptcy proceedings will be made, except in any of the following cases (Bankruptcy Act, Article 30, Paragraph 1, main paragraph).

The order of commencement made immediately becomes effective before the order becomes final and binding (Bankruptcy Act, Article 30, Paragraph 2). This is because, if the order of commencement does not become effective until it becomes final and binding, the bankrupt's property may become dissipated, and hinder subsequent procedures[36].

Bankruptcy barriers are (1) expenses for bankruptcy proceedings are not prepaid (Bankruptcy Act, Article 30, Paragraph 1, Item (1)), and (2) the petition for commencement of bankruptcy proceedings is filed for an unjustifiable purpose or it is not filed in good faith (Bankruptcy Act, Article 30, Paragraph 1, Item (2)).

Foremost, in the case of a petition filed by the supervisory agency with regard to Item (1), while it is difficult to anticipate that there will be no prepayment

---

[36]See KOKUBO, *Comment in p.76*, in YAMAMOTO (eds.), *op. cit. (26)*.

of expenses, there is the issue of whether expenses need to be prepaid to begin with.

With respect to this point, while the secondary function of the prepayment system of preventing the abusive filing of petitions does not apply to a petition filed by the supervisory agency, because numerous expenses are anticipated in the course of proceeding with the procedures, the prepayment of expenses has been acknowledged[37].

Next, in the case of a petition for commencement of bankruptcy proceedings filed for an unjustifiable purpose or not filed in good faith as referred to in Item (2), considered may be cases where a creditor files a petition for causing the debtor to preferentially make payment to himself/herself by threatening the debtor and saying that it will withdraw the petition once the debts are paid, or the debtor files a petition for escaping the creditor's pursuit[38], but it could be said that such cases would not apply to a petition filed by the supervisory agency.

There may be cases where a petition for commencement of bankruptcy proceedings and a petition for commencement of rehabilitation proceedings are both filed against a bank in a competing manner, or cases where bankruptcy proceedings have already been commenced but rehabilitation proceedings are also additionally commenced. In these cases, a stay order may be issued against the bankruptcy proceedings (Civil Rehabilitation Act, Article 26, Paragraph 1, Item (1)), or the bankruptcy proceedings may be automatically discontinued (Civil Rehabilitation Act, Article 39, Paragraph 1) [39].

Similar provisions are also prescribed in the Corporate Reorganization Act (Corporate Reorganization Act, Article 24, Paragraph 1, Item (1), Article 50, Paragraph 1) [40].

---

[37]See UCHIBORI and KAWABATA *Overview of Reorganization Proceedings, etc. of Financial Institutions (Part 2)*, in *NBL*, 1997 n. 613, p. 20. While this description related to the petition to be filed by the supervisory agency in reorganization proceedings, it also applies to bankruptcy proceedings.
[38]See ITO, *op. cit. (26)*, p. 116.
[39]See ITO, *op. cit. (26)*, pp. 117-118.
[40]See ITO, *op. cit. (26)*, pp. 118-119.

The purpose of these provisions is, in cases where (civil) rehabilitation proceedings or (corporate) reorganization proceedings as reconstruction proceedings and bankruptcy proceedings as liquidation proceedings are in conflict, to give preference to the reconstruction proceedings, and position the liquidation proceedings as the final means in cases where the reconstruction proceedings were unsuccessful.

In other words, because the existence of civil rehabilitation proceedings and corporate reorganization proceedings which prevail over bankruptcy proceedings obstructs the commencement and continuation of bankruptcy proceedings, the non-existence of such reconstruction proceedings is also a bankruptcy barrier[41].

8. Before the burst of the bubble economy, when a bank or any other financial institution failed, under the guidance of the Finance Ministry (at the time), the failed financial institution was relieved, pursuant to an agreement between the relieving financial institution and the failed financial institution, by the former succeeding the latter's business by way of absorption-type merger, transfer of operations, or transfer of business[42].

After the burst of the bubble economy, numerous financial institutions, particularly banks, credit cooperatives, and Shinkin Banks, went bankrupt. According to the material of the Deposit Insurance Corporation[43], as of March 2017, financial assistance for failed financial institution reached 182 cases from Toho Sogo Bank to Incubator Bank of Japan, and among these 182 cases 20 were banks (ordinary bank). Among these failed banks, 12 banks transferred their operations to the relieving bank, 4 banks underwent merger (including specified merger), and 1 bank transferred a part of its business to the relieving bank. Furthermore, 1 bank

[41]See ITO, *op. cit. (26)*, p. 117.
[42]See MATSUSHITA, *Business Failure and Insolvency Proceedings of Banks and Cooperative Financial Institutions*, in *Jurist*, 1996, n. 1085, p. 27.
[43]Deposit insurance corporation of Japan, *2016 Deposit Insurance Corporation Yearly Report*, Tōkyō, 2017, pp. 125-134, available at following address: *https://www.dic.go.jp/content/ 000025871.pdf*.

transferred its shares to the bank holding company, and 2 banks underwent the commencement of temporary government control by the Financial Reconstruction Commission.

Nevertheless, insolvency proceedings have not been commenced against any of these domestic failed banks pursuant to the Bankruptcy Act, the Civil Rehabilitation Act, or the Corporate Reorganization Act, let alone the Special Measures Act.

There is no choice but to say that domestic and overseas influence when a bank receives an order of commencement of bankruptcy proceedings, etc. is unknown, and whether there is any limit in the proceedings under the current legal system is also unknown. Accordingly, in order to determine what kind of unexpected problems may arise when a bank fails and what kind of measures would be optimal in such a case, we will need to wait for the accumulation of future cases.

THE REFORM OF THE EMU GOVERNANCE. WHERE DO WE STAND? *

Roberto Tamborini **

ABSTRACT: *The foundations of the outpost of the European Union, its Economic and Monetary Union (EMU), have seriously been shaken by the first stress test of its (short) history, the global economic and financial crisis exploded in 2008. There is now general agreement that reforms of the institutional architecture of the EMU are necessary, aimed at fostering further integration on the grounds of economic policy and governance. Behind this general agreement, however, there are sharp divergences of views and agendas. The aim of this paper is to provide the reader with a broad overview of the "state of the art" in the debate about the EMU reform, presenting the main alternative views, the major issues at stake, and the prospects of reform. At the turn of the year there was a spell of optimism that 2018 would have been the year of the reform of the EMU. Alas, optimism is fading away.*

1. The foundations of the outpost of the European Union, its Economic and Monetary Union (EMU), have seriously been shaken by the first stress test of its (short) history, the global economic and financial crisis exploded in 2008. A storm that Europe initially contemplated from a distance as an American affair, but

---

*This paper draws on an earlier version presented at the conference "Le riforme della governance economica e finanziaria europea", University of Trento (Italy), Department of Law, June 20-21, 2018. I thank the participants for comments. I remain fully responsible for this paper.

**Full professor of Political Economy, Department of Economics and Management University of Trento

which soon rained down on our continent with greater force and for longer time. There is now general agreement among scholars, authorities, and even political leaders, that the dramatic "Europeanisation" of the global crisis was exacerbated and prolonged by flaws inherent in the architecture of the EMU (e.g. Baldwin and Giavazzi (eds.) 2015, 2016; Delatte et al. 2017; CEPR 2018).1

The most compelling problems brought to the forefront by the crisis are two. The first is the "original sin" that no one is in charge for the EMU as a whole at the supranational level with the exception, by statute, of the ECB.2 The second is that the governance mechanisms in place have proved unable to coordinate national policies in order to overcome social and economic costs due to mutual negative externalities. In his fine book *Saving Europe*, Carlo Bastasin (2015a) calls the European crisis the "First interdependence war". In a subsequent paper, he writes:

"I am not using the word war lightly. […] The size of the economic crisis, the loss of production measured against the trend, is in the ballpark of a war. It actually amounts to a higher economic cost than all the wars fought by the United States after 9/11, Iraq, and Afghanistan included […] Throughout the crisis, national governments have acted as if their states were or had to become self-sufficient, live within their own means, and stand on their own two feet. [This goal] became the cornerstone of crisis management and of the European system of economic governance that later emerged" (Bastasin 2015b, pp. 5-6)

Therefore, reforms are deemed necessary, ideally aimed at fostering *further integration* on the grounds of (at least) economic policy and governance. This claim has been endorsed by the top European institutions, with the Commission taking the lead of the reform agenda.3

[1]Data about the comparative worse performance of the EMU members in comparison to other European countries are presented by Tamborini (2015).

[2] In the vas literature on the origins and development of the EMU as a supranational architecture see e.g. Eichengreen and Wyplosz (1998), Mongelli (2010), Spolaore (2015).

[3]As testified by the so-called "Five Presidents Report" (Juncker et al. 2015), the *White Paper about the future of the EU* (2016) and the *Reflection Paper on the Deepening of the Economic and Monetary Union* (2017a), and the subsequent *Roadmap for Deepening the Economic and Monetary Union* (2017b). Relevant speeches of the President of the European Central Bank should also be mentioned (e.g. Draghi 2014a, 2014b, 2015).

The aim of this paper is to provide the reader with a broad overview of the "state of the art" in the debate about the EMU reform, presenting the main alternative views, the major issues at stake, and the prospects of reform. At the turn of the year there was a spell of optimism that 2018 would have been the year of the reform of the EMU. Alas, optimism is fading away.

2. European institutional reforms are eminently a matter of political decisions. Yet they are not just ready for head of governments' signature. The debate has been growing for years. An entire library can be filled with accurate and detailed proposals elaborated by authoritative scholars, think thanks, policy advisors, EU officials. The l*eit motiv* is the plea for further (and faster) integration epitomised by three pillars to be erected in support of the Monetary Union: Banking Union, Fiscal Union, and Political Union.

The Banking Union is under way with two main achievements: the single supervision on major banks, and the single resolution mechanism for bank crises. Negotiations are instead at a stalemate on a third key element, the common deposit insurance (Baldwin and Giavazzi 2016, Part Two). The Fiscal Union, i.e. authorities and rules of fiscal policy in the EMU, is a political enigma, but the general feeling is that "something has to be done" so that most likely it will become the core of negotiations (and controversies). The Political Union remains the ideal end, but it is miles away from the stage of a political agenda.

Let me then concentrate on the Fiscal Union. The reform strategies on the ground are generally represented by two alternative models: the *Maastricht 2.0* and the *U.S.* model – that I would rather call the Confederal model (see also Delatte et al. 2017). Let us examine them in turn.

2.1. In this view, the European crisis originates from the *political* failure of the fiscal regulation system that governments undersigned with the Maastricht Treaty and subsequent modifications up to the Fiscal Compact of 2012. (Schuknecht et al. 2011, Eyraud et al. 2017). It was not the compliance with, but the violation of, these rules that generated the European crisis, whereas these rules remain a fundamental pillar of a sound EMU. The typical symptoms are seen in the persistence of the deficit bias in fiscal policy, public debt growth, transmission of public finance distress.

The culprit is the “politicisation” of the rules, which means that the Commission has deviated from its mandate of impartial and rigorous guardian of the rules to become the interpreter of the rules in the negotiations with governments. Consequently, when the followers of this view talk about “more Europe” they mean further devolution of sovereignty towards supranational agencies essentially "technocratic" in nature with clear mandate and power to enforce the rules *vis-à-vis* the governments (e.g. the European Fiscal Board and national fiscal boards: Asatryan et al. 2017). Two are the keystones of this view.

The first is the reaffirmation of the doctrine of *exclusive national responsibility* in all economic matters, except monetary policy, on which the Treaties ruling the EMU rest. In a context where monetary policy is committed to maintaining price stability, each member country retains full sovereignty, being only required to comply with the fiscal rules established by the Treaties, and with the policy recommendations put forward by the European Commission. On the other hand, non-monetary sovereignty is limited by a set of rules that are necessary to ensure fiscal discipline and "monetary dominance" (i.e. full independence of the European Central Bank *vis-à-vis* governments), knowing that a monetary union creates incentives to violate the principles of fiscal discipline, no bail-out of insolvent governments, and non-monetization of public debt.

In parallel, a peculiar interpretation and implementation of the national responsibility doctrine has materialised according to which the room for manoeuvre and choice of sovereign governments remains such that the performance of each country, whether good or bad, is mostly seen as its own responsibility. In the end, there is no such a thing as "the EMU", which is only the statistical average of what the individual countries are doing. If the EMU as a whole performs poorly, it is only because too large a number of members fail to manage their economy successfully and to follow rules and prescriptions faithfully. Consequently, the blame for failures, and the need for reforms, is mostly placed at the level of individual countries, whereas the general institutional set-up is kept out of discussion.

The second keystone of the Maastrich 2.0 roadmap is the request that the Treaty on Stability, Convergence and Coordination in the Economic and Monetary Union of 2012 (the so-called "Fiscal Compact"), after being embodied in the legislations of member countries, is elevated from the status of an international treaty to the rank of EU legislation.

So far, this reform strategy finds significant political support in Germany (see Schauble (2017), though not officially by the government, and in the North-Eastern belt (e.g. the document undersigned by the Finance ministers from Denmark, Estonia, Finland, Ireland, Latvia, Lithuania, the Netherlands and Sweden).

2.2. On this alternative reform model convergence different strands of critical thinking of the EMU architecture and its "original sins". From the economic side, a number of flaws are present in the original regulatory framework that have become critical in the mismanagement of the crisis: (i) neglect of interdependencies across countries, (ii) insufficient coordination of national fiscal policies, and in the aggregate with the common monetary policy, (iii) lack of common instruments of macro-stabilisation, (iv) enforcement of austerity too large, too early, uncoordinated. The fiscal rules apparatus was designed to control for the negative externalities of fiscal profligacy but not for those of fiscal austerity, which accounts for the deeper and longer recession in the EMU than elsewhere[4]. A related allegation is that the rules failed as substitute for explicit policy coordination[5].

From the political and institutional side, the EMU as a supranational institution lacks "incentive compatibility" with the legitimate role of democratic govern-

[4]About the vast debate on austerity see Corsetti (ed.) 2012, Buti and Carnot (2013), Tamborini (2015).

[5]The single exception may be seen in the "European Semester", introduced within the 2011-12 anti-crisis reform package, with the explicit aim of "coordinating" national fiscal policies, which however belongs more to the category of moral suasion than to full-fledged institutional mechanisms.

ments as representatives of social preferences over policies and their outcomes (Andreozzi and Tamborini 2017). A sharp conflict has emerged between the “community method” (law and decision making are reserved matter of the community bodies) and the “intergovernmental method” (the law of the strongest? Bastasin 2015a, Fabbrini 2015). Tightening the existing regulatory system has already been experimented (the so-called Two Pack, Six Pack, Fiscal Compact, etc.) with poor results on crisis management and further deterioration of the "input" and "output" legitimacy of the EMU policymaking process (Scharpf 2015, Schmidt 2015).

In this view, reforms point to the opposite direction of Maastricht 2.0. The confederal inspiration should be understood in a broad sense, meaning that the aim is the creation of bits of genuine supranational government (not just governance) with clear institutional legitimacy with respect to both the EU order and the national constitutional orders. The most significant political boost in this direction is generally associated with the French President Macron (see his famous Sorbonne speech in November 2017). In December, the then Italian Finance Minister Padoan handed out to his peers a position paper which actually lined up Italy with France.6 Italy, and possibly Spain, might be part of the leading group, but political uncertainties may keep them out. The reform agenda typically includes:

- completing the Banking Union
- transforming the European Stability Mechanism into a "European Monetary Fund", enlarging its mandate and capacity in order to support countries that lose access to capital markets, and to provide adequate capital for the SRM
- creating a genuine "Finance Minister of Europe", with clear political mandate and budget capacity within the EU framework

3. Having outlined the main alternative models of EMU reform, in this sec-

[6]Ministero dell'Economia e Finanza, Reforming the European Monetary Union in a stronger European Union, Rome, December 2017.

tion I will focus on a few issues that are both central to reform plans and particularly controversial, namely the European Monetary Fund, the European Minister of Finance, and the future of the Fiscal Compact and the EMU fiscal policy in general.

3.1. Amid the financial turmoil of 2010-12 it was realised that the EMU was lacking an adequate capacity of lending of last resort. Under the immediate pressure of the Greek crisis, the European Financial Stability Mechanism was created, then transformed into the European Stability Mechanism (ESM) in October 2012 with an initial capital of €81 bln. and lending capacity of €700 bln. On paper the ESM ranks as an outstanding regional stabilisation fund, though doubts are present from the very beginning about its capacity to withstand a Union-wide crisis or even a crisis of large countries like Italy (Lossani 2018).

There seems to be wide agreement to transform the ESM into a stronger EMF, but some critical points stand in the way. High risk exists that it is designed in a way that makes it unusable. Again, the most controversial points are epitomised in two alternatives views, the "Commission view" (2017b) and the "Schauble view" (2017). In essence, the former is akin to the Confederal model, the latter is in line with Maastricht 2.0 (see Lossani 2018).

Lending capacity and range

As said above, it is doubtful whether the present lending capacity of the ESM is sufficient for the new EMF. Moreover, this issue intersects with the design of the Banking Union to the extent that the EMF might enlarge its operation range to include the role of backstop for the bank crises resolution mechanism, and the common deposit insurance, which is at a standstill.

Governance

Proposals sharply differ on this point. Followers of the Commission view claim that EMF should be rooted in the EU legislation, and that it should overcome the intergovernmental and unanimity governance of the ESM. Followers of the Schauble view instead wish that governance and decision-making remain firmly in the hands of governments under the unanimity rule (i.e. the possibility of veto power).

Conditionality

There is broad agreement around the classic principles of lending of last resort: (i) loans should go to illiquid, not to insolvent, borrowers, (ii) they should be conditional on consistent actions that overcome the problem. However, as far as governments are concerned, this is more easily said than done. The IMF longstanding protocols may provide a benchmark, but the unfortunate experience of the IMF involvement in the Greek crisis is telling about the difficulties faced in the EMU (Wyplosz 2013). One critical issue is that conditionality should be calibrated accurately, case by case, because excessive conditionality may transform an illiquid debtor into an insolvent one and trigger the sovereign debt crisis which is supposed to prevent. Also, conditionality should be devised with all means necessary to obtain ownership and compliance by governments (no Troika-style *diktats*).

Surveillance of national public finances

As said above, a tenet of the Maastricht 2.0 model is that this has been a major flaw in the system and its strengthening is a priority. In the Schauble view, the new EMF should be assigned this task too. This proposal seems at odds with the strong preference in the Maastricht 2.0 model for a technocratic body, if the EMF should also retain a substantial intergovernmental nature (see above). However, the common ground is that the implementation of the Fiscal Compact should be subtracted to the Commission. Of course, the Commission view, and also the supporters of the Confederal model, oppose the idea that the EMF is overburdened with this task, which should rather be assigned to another more representative body such as the "European Finance Minister" (see below).

The hurdle of moral hazard

It is important to understand that there is a common critical cleavage across these issues: the problem of moral hazard (which in the EMU context means that the mechanism may hide permanent transfers to "weak" members) inherent in any insurance mechanism, or from a complementary point of view, the problem of mistrust among the EMU members. In the Schauble view, moral hazard is of paramount importance and its resolution is a *sine-qua-non* precondition. However, the true divide between the different views is not so much about the existence of the problem (it does exist and it is important) but about *how* to address it.

All the many authoritative proposals on the table do include mechanisms aimed at minimising moral hazard that take stock of the theoretical literature and long-standing experiences both in the private and public sector. The Schauble view and it followers instead insist on the two-stage strategy of *risk-reduction* prior to *risk-sharing*. This is quite a technical, and subtle, argument that cannot be developed here in depth. However a few considerations are in order.7

Though seemingly reasonable, the two-stage strategy hinges on uncertain foundations. According to the classic theory of risk, the distinction between risk reduction and risk sharing is pointless: risk sharing *is* the means to reduce risk. In this view risk is something intrinsic in an asset (like mass in physics), it cannot be *reduced* in absolute magnitude, but it can be *distributed* efficiently among asset-holders according to their own degree of risk aversion. Consider a bank with large non performing loans. These can be sold at a discount to a specialised intermediary happy with a higher risk-return profile. Both the bank and the intermediary are better-off, but the system as a whole is not safer. Technically speaking, the EMU may be safer if the intermediary is non-resident, but this is some of a hypocritical idea of risk reduction (if the non-resident intermediary goes bust it may have contagious effects on resident intermediaries connected with it). Risk reduction can, at most, be an *ex-ante* policy strategy based on micro- and macro-prudential tools.

A second weakness of the two-stage strategy arises if it is recognised that financial risks are to some extent endogenous. Suppose now that there are many banks with non performing loans who seek to sell them all together. The effect is

[7] A lively debate is under way: see e.g. the most recent document of fourteen French and German economists (CEPR 2018), the reply by some Italian economists, Messori and Micossi (2018), Bini Smaghi (2018), and a speech by the ECB President Draghi (2018).

that the interbank market shrinks, sale prices plummet, volatility increases, and the market value of banks' assets falls. These effects make the whole system *more* risky.

What said above also applies to the case of banks forced to sell sovereign bonds. Here, as in other fields, there seems to be an obdurate resistance to recognise the systemic effects of seemingly efficient policies taken in isolation.

Important as it may be for an accurate design, the fear of moral hazard seems overstretched to cover political fears. Were moral hazard the tombstone of insurance schemes, insurance companies would have not survived. Theory and practice of control of moral hazard has made enormous progress in parallel with risk management techniques. Moreover, it is almost ignored that moral hazard has two sides. Beside the most feared incentive to buy insurance and take on too much risk for all, there is the failure to create insurance as a consequence of under-rating of risk ("it cannot happen to me"). In the former case there is over-insurance, in the latter under-insurance. *Both* are collective failures that impose welfare losses on *each and all* members.

Finally, if risk reduction is a dangerous *ex-post* policy once the *ex-ante* prudential polices have failed, a more sensible approach seems the recognition of the *crisis legacy problem*. A proposal that follows this approach is the so called PADRE (Paris and Wyplosz 2014). Like after wars, the first imperative is to "clear up the mess". History teaches that it is hardly possible to build new and solid institutions and relationships on the ruins of the disaster (compare the different courses of history impressed by the winners after World War I and World War II).

3.2. This is an evocative but elusive idea, quite different in the Maastricht 2.0 or in the Confederal model. A lot of stumbling blocks stand in the way. Clearly the two front matters − how the Finance Minister is appointed and with what mandate and powers – are interconnected: it is hard to decide on one matter before the other. Anyway, let me start from the latter.

What mandate and powers?

A recent assessment of the existing proposals (Asatryan et al. 2018) aptly puts forward a "functional" approach, i.e. to what extent the Finance Minister might contribute to improve on the following dimensions which shine up prominently across various ideas of a well functioning fiscal arm of the EMU: (i) safeguarding fiscal sustainability of member states, (ii) stabilizing EMU against macroeconomic shocks, (iii) stronger incentives for structural reforms, (iv) optimum provision of European public goods through the EU budget.

If there is agreement on the necessity to improve on these goals by means of "further integration", much less agreement exists about whether the EMU needs a Finance Minister.8 In this perspective, the Maastricht 2.0 and the Confederal models can also be distinguished, respectively, according to their preference for *decentralisation* (rule-constrained national responsibility) or *centralisation* (with sovereignty sharing). The Finance Minister is clearly a form of policy centralisation and is therefore problematic for those who think that decentralisation is more efficient, or at least more realistic in the present historical conditions of Europe. For instance, a typical objection by the followers of Maastricht 2.0 on point (i) relates to the concern with "politicisation". While greater coherence in the implementation of fiscal rules may have efficiency gains, they see a material risk that such gains could be more than offset by greater political discretionality. Priorities in the reform of EU fiscal governance are seen elsewhere, such as in the significant simplification of rules and independent institutions. However, should the Minister be put in place, the related politicisation risk could be mitigated by giving more power to the European Fiscal Board in a checks and balances logic.

Particularly critical is the fact that some of the key functions of the Finance Minister (e.g. (ii) and (iv)) necessarily require a true EU budget. The key issue of the dimension and destination of the EU budget remains controversial, with a well entrenched resistance line. Some aggregate stabilisation tools or lines of investment may find their way, whereas full-fledged instruments of debt sharing, risk

[8] The conclusion of the above mentioned paper is that the Minister might do well in some matters, (ii) and (iii), but not in others, (i) and (iv).

sharing or fiscal transfers will hardly have a chance.

How is the Finance Minister appointed?

At least three "formats" of Minister have been put forward. The Commission (2017c) proposes that the Minister is the president elect of the Eurogroup and Vice-president of the Commission. Moreover, he/she would chair the ESM and – once this is established - the EMF. He/she would represent the Commission in the meetings of the ECB's Governing Council and also be responsible for EU-level social dialogue and interaction with important stakeholders. And finally, the Minister would be accountable to the European Parliament. This proposal seems to be bending towards a political profile of the Minister. But the legitimacy problem is far from being solved. The Eurogroup itself is a problematic entity, that many regard as too intergovernmental and ill placed within the EU order. It is not by multiplication of chairs that this problem can be resolved.

A second profile is akin to a non-political body modelled on the European Fiscal Board. This profile, while possibly including policy orientation, harmonization and guidance for the EMU as a whole, is more focused on the aim of monitoring and controlling national policies in compliance with the commitments to fiscal discipline. Hence, this is also more in tune with the Maastricht 2.0 model of EMU reform.

In a third view, more consistent with the Confederal model of reform, the Minister should be designed with consideration of *legitimacy*, *competency*, *normative power*. These requisites can only be found in a collegiate body with some clearly identifiable democratic legitimacy, albeit indirect. The natural solution is that the Minister is (the elected chairperson of) a council of national ministers (call it "Eurogroup 2.0").9 Common inspiration is the well-known leading principle of institutional design of separation between political and non-political bodies with a clear-cut red line. Both the chairperson and the collegiate body should better be

---

[9]This idea has been circulated under various shapes: the European Fiscal Institute (Tabellini 2016), the Euorsystem of Fiscal Policy (Sapir and Wolff 2015), the European Federal Institute (Guiso and Morelli 2014), and, unnamed, is also present in the French-German economists' proposal (CEPR 2018).

independent of the Commission or of other non-political bodies. At the same time, this kind of Minister should also be accountable *at the EMU level*, not only *vis-à-vis* national constituencies. In parallel, the European Fiscal Board may retain, or even enhance, its role of independent control *vis-à-vis* the Minister. In a nutshell, these are nothing else than reproductions of the classic system of checks and balances on which modern democracies rest.

3.3. The issue of the reform of fiscal governance will revolve around the Fiscal Compact, and in the first place whether it should become integral part of the EU legislation (at the moment it is "only" an international treaty). The Commission and the supporters of Maastricht 2.0 are strongly in favour. France's position is unclear, though it may bend towards a softer version as a compromise. Italy has already said no with bipartisan voice.

Fiscal rules and macroeconomic stabilisation

Main arguments of critics of the Fiscal Compact as-it-is are that, first, the Fiscal Compact does not resolve (it possibly worsens) the problems created by the fiscal rules during the crisis. Second, federal systems show that if national budgets are to be constrained significantly, then they should be smaller than they are in the EMU members; more competences should be moved to the supranational level (you cannot have both the Fiscal Compact and no EMU budget). The concern is therefore that an uncompromised enforcement of the Fiscal Compact interferes with the goal of enhancing the stabilisation capacity of the EMU, which ranks high in the agenda of EMU reforms (Baldwin and Giavazzi (eds.) 2106, Part 3; CEPR 2018). The agenda, with variable degree of agreement, includes

- rewriting the national fiscal rules in a simpler and more transparent way, removing procyclical mechanisms, and with a shift of focus from year deficits to medium-long term evolution and sustainability of debt
- better coordination of national fiscal policies so that reciprocal spillovers are taken in due account as well as the *aggregate* fiscal stance of the EMU *vis-à-vis* the ECB in order to achieve better coordination between the monetary and the

fiscal arm of stabilisation

• manage a few common resources acting as "shock absorbers" (from unemployment insurance schemes to support for public investments)

If creating new common stabilisations tools is not an easy task, it appears less demanding, from the institutional and political point of view, in comparison with more ambitious steps towards further integration. Had some concrete measures been taken in due time, the effects of the crisis would probably have been less dramatic, not least for the credibility of the EMU in the eyes of the citizens. Further inertia on this ground seems hardly justifiable. First of all, fiscal policy can entirely remain under the responsibility of sovereign governments. Second, fiscal rules, whether in their present form or, possibly, reformed, need not be abolished. They may be good for normal times, yet the coordination institution should have the *formal and codified power* to suspend them and indicate appropriate fiscal policies for each member, whenever the latter are expected to produce better outcomes.10 This codification is of the utmost importance in order to avoid disorderly, arbitrary and opaque negotiations concerning the application of the rules, with the inappropriate involvement of the Commission and its exposure to the (hypocritical) allegation of being "politicised".11

Rules versus discretion

More deeply, the Fiscal Compact presents foundational problems inherent in the ideology of rules vs. discretion of governments on which the US Neoliberalism and the German Ordoliberalism have converged. The substantial point is that the destiny of the Fiscal Compact cannot be decided independently of the model of Union that we want to have.

At the end of the day, the whole matter under discussion is about contracts

---

[10]An early experiment in this direction, almost fell into oblivion, was the European Recovery Plan launched in the immediate aftermath of the 2008-09 recession whereby the Commission indicated for each country the extent of appropriate fiscal stimulus regardless of the 3% ceiling.

[11]As Bini Smaghi writes, "It is an academic illusion to think that fiscal policy can be run through simple rules, especially at times of crises, where the depth of the recession needs to be carefully assessed to avoid pro-cyclicality, or outsourced to Fiscal councils, national or European" (2018, p.8)

among governments (high-rank contracts of quasi-constitutional level). These involve mutual trust and credibility. "Credibility" has two meanings: one is whether commitments *will* be respected; the other is whether they *can* be respected. History matters, of course. But the problem eventually lies in the fundamental issue of uncertainty and *contract incompleteness*. Since the ideal conditions of complete contracting (a complete specification of "if … then" clauses in all possible states of the world) seldom occur in reality, the clear-cut solutions to be found in the "rules, not discretion" prescription can hardly be applied. Let me quote a thinker regarded as the pole star of liberalism:

If man is not to do more harm than good in his efforts to improve the social order, he will have to learn that in this, as in all other fields were essential complexity of an organized kind prevails, he cannot acquire the full knowledge which would make mastery of the events possible" (von Hayek 1974, p. 7).

What we do observe (except in the EMU?) is that the higher the legal rank of the contract, the more the contract contains general and abstract principles (or the less it contains specific and state-contingent mandatory rules). "Discretion" is the necessary evil, as it were, of incomplete contracts, and the true task of high-rank charts is how to discipline, not suppress, discretion. This is generally accomplished under two dimensions. First, define who is legitimised to exert discretionary decision-making – in liberal democracies these are elected representatives. Second, strike a balance between tying the hands of the decision-maker (minimise the abuse of authority) and its scope of effective discretion in the face of unforeseen contingencies (remembering that the electors do expect the elected to exert their powers in such contingencies).

At the root of the problems that cripple the EMU and its further progress, I think, lies an obdurate illusion to circumvent these fundamental questions of viable, credible, long-lasting legal charts. We may offer a good service if we make an effort to bring this challenge to the forefront.

4. It is natural to wonder how is it that so far no one of the many proposals

for EMU reform on the table has got political support. The answer is simple. There is general dissatisfaction with the *status quo*, but diagnoses and cures (and national interests) differ at the political level, hence reform agendas differ too. Therefore, Europe in the near future will be the field not only of the battle between pro-Europe and anti-Europe forces, but at the same time of the confrontation between different views of the future of Europe. This will be more gentle and polite, but no less hard and probably more fundamental. If anything because a bad reform, or no reform, will also, more sooner than later, pave the way to the final victory of the mounting anti-Europe forces.

Indeed, the climate is quickly worsening. The latest summit in June 2018, which was expected to lay the foundations of the EMU reform, was a *fiasco*.

Contrary to the prediction of experts in international relations, the wide agenda of the summit did not help find agreements by way of interest compensations across issues. Starting from with the migrant crisis, the number of non-negotiable matters was multiplied. The EMU reform was simply put aside to an indeterminate future.

Genuine reformers will need the credible determination to present all other players with a clear-cut alternative: either a serious reform is begun here and now, with all the necessary ingredients, those which "the South" dislikes as well as those which "the North" dislikes, or everyone will have to take their own share of responsibility for saying ‘No’ to give the EMU a future.

References

Andreozzi L., Tamborini R. (2017, "We need more Europe. Which Europe? Hints from policy games" EconPol Wotking Papers, n. 5, 2017 http://www.econpol.eu/publications/working_paper_5

Asatryan Z., Debrun F., Heinemann M., Horvath L., Yeter O. L. (2017) "Making the Most of the European Fiscal Board." ZEW Policy Brief No. 3, April.

Asatryan Z., Debrun X., Havlik A., Heinemann F., Kocher M., Tamborini R. (2018), *Which Role for a European Minister of Economy and Finance in a European Fiscal*

Union? EconPol Policy Report, n. 6. http://www.econpol.eu/publications/ policy_ report_6

Baldwin R., Giavazzi F. (eds., 2015), *The Eurozone Crisis. A Consensus View of the Causes and a Few Possible Solutions*, London: CEPR Press.

Baldwin R., Giavazzi F. (eds., 2106), *How to fix Europe's Monetary Union: Views of Leading Economists*, London: CEPR Press.

Bastasin C. (2015a), *Saving Europe: Anatomy of a Dream*, Washington: Brookings Institution Press.

Bastasin C. (2015b), "The Euro and the End of 20th Century Politics", School of European Political Economy, LUISS University, Rome, Policy Brief n. 10.

Bini Smaghi L. (2018), " Reconciling Risk Sharing With Market Discipline", Policy Brief, School of European Political Economy, LUISS University, Rome, January 30.

Buti M., Carnot N. (2013), "The Debate on Fiscal Policy in Europe: Beyond the Austerity Myth", ECFIN Economic Brief, n. 20.

CEPR (2018), "Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform", Policy Insight, n. 91.

Corsetti G. (ed., 2012), *Austerity: Too Much of a Good Thing?*, London: CEPR Press.

Delatte A., Fuest C., Gros D., Heinemann F., Kocher M., Tamborini R. (2017) *The Future of Eurozone Fiscal Governance*, EconPol Policy Report, n. 1. http://www.econpol.eu/publications/policy_report_1.

Draghi M. (2014a), "Unemployment in the Euro Area", Speech at the Annual Central Bank Symposium in Jackson Hole, August 22.

Draghi M. (2014b), "Stability and Prosperity in Monetary Union", Speech at the University of Helsinki, November 27.

Draghi M. (2015), "President's Introductory Remarks at the Regular ECON Hearing", Brussels, September 23.

Draghi M. (2018), "Risk-Reducing and Risk-Sharing in Our Monetary Union", European University Institute, May 11.

Eichengreen B., Wyplosz C. (1998), "Stability Pact: More than a Minor Nuisance?", *Economic Policy*, pp. 67-112.

European Commission (2016), *White Paper on the Future of Europe*, Brussels, March.

European Commission (2017a), *Reflection Paper on the Deepening of The Economic and Monetary Union*, Brussels, May.

European Commission (2017b), *Roadmap for Deepening the Economic and Monetary Union*, Brussels, December.

European Commission (2017c). "A European Minister of Economy and Finance", Communication, Brussels 6.12.2017, COM (2017) 823 final.

Eyraud L., Gaspar V., Poghosyan T. (2017), "Fiscal Politics in the Euro Area", IMF Working Paper, n. 18.

Fabbrini S. (2015), *Which European Union? Europe After the Euro Crisis*, Cambridge (UK): Cambridge University Press.

Guiso L., Morelli F. (2014) “Fixing Europe in the Short and Long Run: the European Federal Institute”, *Vox EU*, 3 November.

Juncker J. C. et al. (2015), "Completing Europe's Economic and Monetary Union", Brussels, European Commission.

Lossani M. (2018), "Dall’ESM all’EMF. La trasformazione dello European Stability Mechanism nello European Monetary Fund", in *Riformare l'Europa*, Osservatorio Monetario, Università Cattolica di Milano, n. 2.

Messori M., Micossi S. (2018), "Counterproductive Proposals on Euro Area Reform by French and German Economists", Policy Brief, School of European Political Economy, LUISS University, Rome, February 13.

Mongelli F. P. (2010), "On the Benefits and Costs of a Monetary Union", CEPR, Policy Insight, n. 46.

Pâris P. Wyplosz C. (2014), *PADRE: Politically Acceptable Debt Restructuring in the Eurozone,* Geneva Special Report on the World Economy, n. 3.

Sapir A., Wolff G. (2015) “Euro Area Governance: What to Reform and How to Do it”, Bruegel Policy Briefs, February.

Scharpf F. W. (2015) "Political Legitimacy in a Non-Optimal Currency Area", Max Planck Institute for the Study of Society, Discussion Paper n. 13.

Schauble, W. (2017), "Non-paper for Paving the Way to a Stability Union".

Schmidt V. A. "The Eurozone's Crisis of Democratic Legitimacy: Can the EU Rebuild Public Trust and Support for European Economic Integration?", *European Economy*, ECFIN, Discussion Paper, n. 15.

Schuknecht L., Moutot P., Rother P., Stark J. (2011), "The Stability and Growth Pact. Crisis and Reform", ECB Occasional Paper Series, n. 129.

Spolaore E. (2015), "The Political Economy of European Integration" NBER Working Paper, n. 21250.

Tabellini G. (2016), "Building Common Fiscal Policy in the Eurzone", in Baldwin R., Giavazzi F. (eds., 2106), *How to fix Europe's monetary union: Views of leading economists*, London: CEPR Press.

Tamborini R. (2015) "Transatlantic austerity, 2010-13. A comparative assessment", in Paganetto L. (ed.), *Anaemic Europe - How to Achieve Dynamism and Mass Flourishing*, Wien, Springer, pp. 123-161.

von Hayek F. A., "The Pretence of Knowledge",Nobel Memorial Prize Lecture, reprinted in *American Ecconomic Review*, 1989, vol. 79, pp. 3-7.

Wyplosz C. (2013), "Europe's Quest for Fiscal Discipline", *European Economy*, Economic Papers, n. 498.

DOS AND DON'TS OF BREXIT: THE FUTURE OF THE UK FINANCIAL SERVICES SECTOR [*]

Andreas Kokkinis[**] - Andrea Miglionico[***]

ABSTRACT: *This article examines the various possible scenarios for the UK financial services sector post-Brexit, and explores in more detail the case of credit rating agencies (CRAs) and the relationship with the Banking Union. The first part of this article sets out the stark choice the UK faces between EEA membership and third country status in the context of financial services and discusses the complex notion of equivalence under current EU financial legislation and the challenges equivalence presents, as the legal basis for the future relationship between the UK and EU financial sectors. The second part of the article focuses on the impact of Brexit on CRAs highlighting the possible dismantlement of EU legislation that could leave CRAs completely unregulated, which would exacerbate the problems with the liability of rating agencies and the governance of the ratings industry. The second part also analyses the consequences of Brexit in relation to the Banking Union and, in particular, to the banking recovery and resolution framework. It is argued that the UK may adopt different regulatory regimes for restructuring banks in crises generating risks of inconsistency in the implementation of resolving tools.*

---

[*] This article is a result of joint research. Sections 1, 2 and 3 have been written by A. Kokkinis. Sections 4, 5 and 6 have been written by A. Miglionico. Sections 1 and 6 present joint reflections on the subject matter.

[**] Assistant Professor, University of Warwick, School of Law. E-mail: a.kokkinis.1@warwick.ac.uk.

[***] Lecturer in law, University of Reading, School of Law. E-mail: a.miglionico@reading.ac.uk.

1. At the aftermath of the referendum held on 23 June 2016, the UK is due to leave the European Union (EU) on 29 March 2019. Brexit raises several causes of concern in the financial sector, such as the ability of UK firms to offer financial services in the EU, whether UK-based central clearing counterparties (CCPs) will continue to satisfy the obligation to use a CCP, and whether the London Stock Exchange (LSE) will continue to satisfy the obligations of investment funds in connection to shares with a dual listing.[1] The impact of Brexit on financial services and markets is still difficult to foresee with any satisfactory degree of accuracy, as the future relationship between the UK and the EU will be largely determined by the political situation in the UK.[2]

Many commentators have assumed that the UK will leave the Single Market because the Prime Minister[3] and Government[4] have insisted on multiple occasions that this is the only way to give substantive effect to the decision of the British people to leave the EU. On the other hand, joining the European Economic Area (EEA)[5] and thus remaining part of the Single Market appears to be favoured by parts of the Conservative Party as an alternative plan in case it is not possible to reach a satisfactory withdrawal agreement or parliament rejects the withdrawal

---

[1]The Commission has highlighted these issues, which will be explored in detail below, in notices it published in early 2018. See Commission, 'Notice to stakeholders: Withdrawal of the United Kingdom and EU rules in the field of markets in financial instruments' (Brussels, 8 February 2018) and 'Notice to stakeholders: Withdrawal of the United Kingdom and EU rules in the field of post-trade financial services' (Brussels, 8 February 2018), available at https://ec.europa.eu/info/publications/180208-notices-stakeholders-withdrawal-uk-banking-and-finance_en, accessed 6 August 2018.

[2]For an overview of the areas of agreement and disagreement between the two sides and of the available models for the new relationship between the UK and the EU, see European Union Committee, *UK-EU relations after Brexit* (HL 2017-19, 149).

[3]Theresa May, Prime Minister, 'Mansion House Speech' (Speech at Mansion House, London, 2 March 2018), available at https://www.bbc.co.uk/news/uk-politics-43256183, accessed 6 August 2018.

[4]HM Government, 'The future relationship between the United Kingdom and Europe' (Cm 9593, 2018) 1.

[5]The European Economic Area was created by the Agreement on the European Economic Area [1994] OJ L1/3. It is an international treaty originally between the 12 EU Member States and the European Free Trade Association States. These were at the time the following: Norway, Lichtenstein and Iceland (which are still members of EFTA and the EEA), Austria, Sweden and Finland (which joined the EU in 1995) and Switzerland, which never ratified the Agreement due to its rejection by a referendum in December 1992.

agreement.[6] Support for a second referendum, which might even reverse Brexit altogether, is also growing amongst civil society organisations and at Westminster, although currently the only significant nation-wide party that supports this idea is the Liberal Democrats.

This article, therefore, canvasses the various possible scenarios for the UK financial services sector post-Brexit, before exploring in more detail the case of credit rating agencies (CRAs) and the relationship with the Banking Union. Section two sets out the stark choice the UK faces between EEA membership and third country status in the context of financial services. Section three examines the complex notion of equivalence under current EU financial legislation and the challenges equivalence presents, as the legal basis for the future relationship between the UK and EU financial sectors. Section four focuses on the impact of Brexit on CRAs. Section five explores the consequences of Brexit in relation to the Banking Union and, in particular, to the banking recovery and resolution framework. The last section provides concluding observations.

2. This section will briefly explain the EEA option, and will then focus on the more likely scenario where the UK leaves the Single Market.[7] The Single Market's territorial extent is broader than the EU, as it also encompasses three of the European Free Trade Association (EFTA) Member States,[8] and – to a limited extent – Switzerland through bilateral treaties.[9] Those areas of EU law that derive from

---

[6]See PARKER, 'Michael Gove discusses backstop UK plan to stay in single market' *Financial Times* (London 2 August 2018), available at https://www.ft.com/content/722039cc-9579-11e8-b67b-b8205561c3fe, accessed 6 August 2018.
[7]The following part of the discussion draws on KOKKINIS, 'The impact of Brexit on the legal framework for cross-border corporate activity' (2016) 27(7) *European Business Law Review*, 963-966.
[8]The European Free Trade Association is an intergovernmental organisation established by a Convention on 4 January 1960. Its original signatories were the United Kingdom, Austria, Denmark, Norway, Portugal, Sweden and Switzerland. Iceland joined in 1970, Finland in 1986 and Lichtenstein in 1991. However, the importance of EFTA gradually declined. Indeed, the UK and Denmark left in 1973, Portugal in 1986 and Austria, Finland and Sweden in 1995. As a result, EFTA currently has four members: Iceland, Lichtenstein, Norway and Switzerland.
[9]The ten bilateral treaties granting Switzerland partial membership of the Single Market were signed in two phases, the first seven in 1999 and the last three in 2004. They cover areas such as the free movement of persons, technical trade barriers, public procurement, agriculture, air and land

the fundamental Treaty[10] freedoms of movement of: goods, services, capital, and persons are equally applicable to countries that are not part of the EU but are part of the Single Market. All the EU acquis that is relevant to financial services and markets falls in that category. The EEA Agreement covers in particular: (1) the free movement of workers; (2) recognition of professional qualifications; (3) the right of establishment; (4) financial services; (5) services in general; (6) the free movement of capital; and (7) EU company law rules. It follows that, if the UK joins the EEA, nothing will change for the UK financial markets and firms and all the economic benefits that UK firms currently enjoy, including passporting rights, would continue as they stand.[11]

This would come at the cost of the UK having to follow any new EU rules in these areas, without having anymore any official voice and power to shape such rules. Indeed, EEA countries are legally obliged to implement all new EU law rules that fall within the scope of the EEA Agreement subject to their approval by special joint committees that include representatives from the EU and EEA. New EU legislation is incorporated into the EEA Agreement by consensus of all EEA states. The process is facilitated by a number of institutions, including the EFTA Standing Committee (of ambassadors to the EU), the EFTA Surveillance Authority, and the EFTA Court.[12] The process is led politically by the EEA Council (foreign ministers of the EEA States and of the EU Member State which holds the presidency). The actual decision to incorporate applicable EU legislation has to be taken unanimously by the EEA Joint Committee, which consists of the EFTA Standing Committee and

---

transport, and Switzerland's participation in the Schengen and Dublin agreements. For a discussion of the position of Switzerland in the Single Market, see Stephan Breitenmoser, 'Sectoral Agreements between the EC and Switzerland: Contents and Context' (2003) 40(5) *Common Market Law Review*, 1137.

[10]Consolidated Version of the Treaty for the Functioning of the European Union (TFEU) [2012] OJ C236/47, Art 26(2).

[11]See ALEXANDER, 'The UK's Third-Country Status Following Brexit: Post-Brexit Models, Third-Country Equivalence and Switzerland' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Oxford: Hart Publishing 2018) 118-121. Armour has also argued that a 'soft' Brexit is the safest option for the City. John Armour, 'Brexit and Financial Services' (2017) 33 *Oxford Review of Economic Policy* (suppl. 1) 54.

[12]An analysis of the jurisprudence of the EFTA Court can be found in EFTA Court (ed), *The EEA and the EFTA Court* (Hart Publishing 2015).

the European External Action Service.[13] The Joint Committee scrutinises each piece of legislation to ensure it falls within the scope of the EEA Agreement. EEA countries have the theoretical right to refuse the application of new EU law, but such right has never been exercised since doing so would give the EU the right to terminate the whole EEA Agreement. This explains the strong resistance of many UK politicians to EEA membership as it would effectively bind the UK to follow EU rules without being represented on the EU institutions and fora. Of course, in such a scenario the UK, given its technical expertise and the size of its financial market, would retain the possibility of influencing the direction of EU law in soft ways through lobbying Member States' governments, providing technical assistance to EU authorities and contributing to the development of international financial regulation international financial regulation such as the Basel Committee and IOSCO.

From the perspective of the financial services, it is worth noting that there are effectively two models of the future relationship between the UK and the EU: either full EEA membership or ordinary third country status, which may benefit from equivalence. Regarding the Swiss model, although it is a distinct blueprint for an institutional arrangement with the EU, from the perspective of the financial markets and services, it would amount to little more than ordinary third country status. This is because much of the Single Market acquis does not apply to Switzerland. Although EU law that is based on the free movement of persons (natural and legal) applies, most EU law on financial services and financial markets does not apply.[14] Moreover, the bilateral treaties between the EU and Switzerland do not provide for the incorporation of new pieces of EU legislation.[15] This has led the EU

[13]This is an Agency established for this purpose in 2010. Until then the Commission represented the EU on the EEA Joint Committee.

[14]However, note that a special bilateral agreement allows Swiss general insurance firms to set up agencies and branches in EEA States and vice versa: Agreement between the European Economic Community and the Swiss Confederation of 26 July 1989 on direct insurance other than life insurance [1991] OJ L205/3.

[15]Indeed, any expansion of Switzerland's participation in the Single Market can only achieved by concluding additional bilateral treaties, which has led to a proliferation of treaties, exceeding now 120.

Council to state that no further bilateral treaties will be concluded and to request Switzerland to agree an appropriate institutional framework to ensure the coherence of the Single Market.[16] In any case, in the area of financial services, Swiss policy in recent years has focused on making Swiss law mirror EU law, so that Swiss firms can benefit from equivalence determinations and gain some access to the Single Market, rather than on new bilateral treaties.[17]

It is now pertinent to examine the possibility of financial services to be included in a future free trade agreement between the UK and the EU. Of course, it is theoretically possible for the UK and EU to conclude a free trade agreement with a chapter on financial services that would grant access to each other's markets and provide for mutual recognition of each other's regulatory frameworks or parts thereof. Such an agreement would grant UK financial firms passporting rights (probably using different terminology) to operate in the EU and vice versa, and would include institutional arrangements to ensure that the regulatory frameworks of the UK and EU do not diverge in the future within the scope of such rights of access. Indeed, the Chancellor has consistently advocated this option as it would provide UK financial firms with the necessary legal certainty and clarity. He canvassed this scenario as follows:

'[T]he principle of mutual recognition and reciprocal regulatory equivalence, provided it is objectively assessed, with proper governance structures, dispute resolution mechanisms, and sensible notice periods to market participants clearly could provide an effective basis for such a partnership. And although we will be separate jurisdictions, we would need to maintain a structured regulatory dialogue to discuss new rules proposed by either side building on our current unparalleled regulatory relationships to ensure we deliver equivalent regulatory out-

[16] See AYDAN, BAHADIR and FERNANDO, GARCÉS DE LOS FAYOS, The European Economic Area (EEA), Switzerland and the North (2016), available at http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuId=FTU_6.5.3.html, accessed 6 August 2018.
[17] See ALEXANDER (n 11) 143-145.

comes agreeing mutually acceptable rule-changes where possible. ' [18]

Tempting as this scenario may be for UK financial firms and their management, the prospect of including the financial services within a future free trade agreement between the UK and EU looks dim due to the firm position taken by the Commission and Michel Barnier. Their position is that the UK will face a stark choice between: EEA membership and a Canada-style free trade agreement covering (most) goods, but not services.[19] This appears to have been reluctantly accepted by the UK Government, which in its much discussed Chequers white paper concedes that access to financial markets will be a matter of equivalence rather than mutual recognition:

'This new economic and regulatory arrangement would be based on the principle of autonomy for each party over decisions regarding access to its market, with a bilateral framework of treaty-based commitments to underpin the operation of the relationship, ensure transparency and stability, and promote cooperation. […] As part of this, the existing autonomous frameworks for equivalence would need to be expanded, to reflect the fact that equivalence as it exists today is not sufficient in scope for the breadth of the interconnectedness of UK-EU financial services provision.' [20]

Evidently, the Government is still hoping for a governance framework that would be enshrined in a legally binding treaty but does not seek automatic mutual recognition, but rather unilateral equivalence granted autonomously, in line with current practice. So, it appears that, barring a major U-turn leading to the UK joining the EEA, the future relationship between the UK and EU in the area of financial services and markets will be based on autonomous and unilateral determinations

---

[18]See HAMMOND, Chancellor of the Exchequer, 'Speech on Financial Services at HSBC' (Speech at HSBC Headquarters, London, 7 March 2018), available at https://www.gov.uk/government/speeches/chancellors-hsbc-speech-financial-services, accessed 6 August 2018.

[19]See BRUNSDEN, 'EU rejects Brexit trade deal for UK financial services sector' *Financial Times* (London, 31 January 2018), available at https://www.ft.com/content/7f7669a4-067f-11e8-9650-9c0ad2d7c5b5, accessed 6 August 2018. See also BRUNSDEN, 'Brexit Britain faces services squeeze with Canada-style deal' *Financial Times* (London, 12 December 2017), available at https://www.ft.com/content/30a358ac-dda6-11e7-8f9f-de1c2175f5ce, accessed 6 August 2018.

[20]See 'The future relationship between the United Kingdom and Europe' (n 4) 30.

of regulatory equivalence. In the worst case, from the UK's perspective, this will operate exactly as the current EU framework on equivalence. In the best case scenario, there will be a binding treaty providing for an institutional framework for the making of such determinations on the basis of the following principles: regulatory dialogue, supervisory cooperation, transparent and objective assessment methodology and a presumption against unilateral changes that narrow the terms of existing market access regimes.[21] The next section, therefore, analyses the current way in which equivalence operates in EU financial legislation before exploring potential ways to shape the institutional framework governing equivalence in the future.

3. Several pieces of EU financial legislation include equivalence clauses which effectively allow some degree of market access to the Single Market for firms that are governed by the law of third countries, provided that the legal and regulatory framework of these countries is deemed to be equivalent to the European framework.[22] In these cases, the determination of equivalence is made for the whole of the EU by the Commission and is liable to be withdrawn at any time. However, the notion of equivalence is also used more broadly to determine compliance with EU rules for non-EU firms. In that sense, equivalence is not about market access but rather about allowing a third country firm to demonstrate compliance with any EU law provision which applies to it due to its operations in the EU. An example of that, is the ability to treat certain exposures in a beneficial way in the context of capital adequacy regulation under CRR.[23] Furthermore, other

[21]Ibid 31-32.

[22]For an overview of various types of equivalence provisions in EU financial legislation and of the distinction between equivalence and passporting, see Directorate-General for Internal Policies (IPOL), 'Third-country equivalence in EU banking legislation' (Briefing Paper of the European Parliament PE 587.369, 12 July 2017), at http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf, accessed 6 August 2018. See also European Union Committee, *Brexit: financial services* (HL 2016-17, 81) 47-49. From the post-Brexit UK perspective, see FERRAN, 'The UK as a Third Country Actor in EU Financial Services Regulation' (2017) 3(1) *Journal of Financial Regulation*, 40.

[23]Capital Requirements Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and

pieces of EU legislation – especially in the areas of prospectuses, transparency, investment funds and alternative investment funds – empower the competent authority of each Member State to determine whether a firm from a third country is subject to equivalent legal requirements on a particular issue, in order to determine the firm's compliance with the requirements of EU law.[24] In the latter cases, the decision lies within the competent authority of the Member State where the third country firm seeks to obtain authorisation or undertake activities.[25] For the purposes of the present discussion it is necessary to explore in more detail the instances where passport-like equivalence is granted centrally by the Commission.

This occurs in three areas, all of them belonging to the wholesale markets: (1) offering investments services to professional clients; (2) reinsurance activities[26]; and (3) the operation of central clearing counterparties.[27] The former of these regimes is the most comprehensive and thus warrants further examination. Indeed, in the area of investment services, the relevant framework is prescribed

amending Regulation (EU) No 648/2012 [2013] OJ L176/1, arts 107(3)-(4), 114(7), 115(4), 116(5), and 132(3).

[24]See Directive 2009/65/EC of The European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) [2009] OJ L302/32, art 50(f). Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64, art 20. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L390/38, art 23. Directive 2011/61/EU of the European Parliament and of The Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L174/1, art 37.

[25]The UK Financial Conduct Authority, for instance, has made equivalence decisions regarding disclosure rules for Switzerland, the United States, Canada and Japan. See FCA, Equivalence of Non-EEA regimes (2016), available at https://www.fca.org.uk/markets/ukla/regulatory-disclosures/equivalence-non-eea-regimes, accessed 6 August 2018.

[26]See Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) [2009] OJ L335/1, art 172 and 227. For a concise discussion, see Alexander (n 11) 142.

[27]See Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1, Art 25(6). In brief, the Regulation stipulates that a third country CCP may provide clearing services to clearing members or trading venues established in the EU only if the CCP in question has been recognised by ESMA, which can only happen if an equivalence determination has been previously made by the Commission.

by articles 39-43 MiFID[28] and 46-49 MiFIR.[29] Briefly speaking, a firm from a third country is allowed to provide investment services to professional clients in the EU without the need to set up a subsidiary or even a branch insofar as it is registered with the European Securities and Markets Authority (ESMA).[30] ESMA will only register a firm, if there has been prior adoption by the Commission of an equivalency decision regarding the legal and regulatory framework of the relevant third country. Notably, cooperation arrangements must be established between ESMA and the competent authorities of the third country. On the contrary, the provision of investment services to retail customers by third country firms remains within the discretion of Member States, which may impose a requirement that the firm sets up a branch or subsidiary in their territory.

Turning to the decision-making process regarding equivalence under MiFID II/MiFIR, the Commission has to certify that the prudential and conduct of business framework of the third country is equivalent to the EU framework. This evidently entails a broad appraisal of the foreign framework. In particular, the Commission must be satisfied that the firm is subject to an authorisation requirement and ongoing supervision; sufficient capital requirements; sufficient organisational requirements; appropriate conduct of business rules; and that there are rules preventing market abuse.[31] In any case, the Commission's decision is discretionary. This process has not yet been tested as there has not been any determination of equivalence under the aforementioned rules at the time of writing, which is unsurprising given the short time that has lapsed since the implementation date for MiFID II/MiFIR.

However, there have already been determinations of equivalence under another provision of MiFIR which is not one granting market access, but rather

[28]See Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) [2014] OJ L173/349.
[29]See Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 [2014] OJ L173/84. From now on to be abbreviated as MiFIR.
[30]For a detailed discussion, see Alexander (n 11) 134-142.
[31]See MiFIR, art 47 (1) (a) – (e).

falls in the category of determining compliance with substantive rules of EU law. Indeed, article 23 MiFIR requires investment firms to ensure that any trade they undertake in shares which are admitted to trading on a regulated market, or are traded on a trading venue only takes place on regulated markets or third-country trading venues assessed by the Commission as equivalent. This means that if an investment firm wants to trade in a share which is listed on one of the EU stock exchanges it has to trade on this share only on an EU stock exchange or on an exchange of a country whose regime has been deemed to be equivalent. Apparently, this is practically significant in the case of dually listed shares which are listed on an EU exchange and a non-EU exchange. To date the Commission has determined that the legal and supervisory framework for national securities exchanges and alternative trading systems of the following countries is equivalent to the EU framework: Australia,[32] Hong Kong,[33] Switzerland[34] and the USA.[35] These decisions need to be complemented by cooperation arrangements. The UK will be highly likely to achieve a similar determination in due course.

Regarding the policy of the Commission on its exercise of discretion under equivalence provisions in general, it recently described the criteria that guide its discretion as follows:

'[The Commission] takes into account objectives stemming from the empowering legislation and from the Treaty. These objectives may include in particular promoting the internal market for financial services and protecting financial

---

[32]See Commission Implementing Decision (EU) 2017/2318 of 13 December 2017 on the equivalence of the legal and supervisory framework in Australia applicable to financial markets in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/81.

[33]See Commission Implementing Decision (EU) 2017/2319 of 13 December 2017 on the equivalence of the legal and supervisory framework applicable to recognised exchange companies in Hong Kong Special Administrative Region in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/87.

[34]See Commission Implementing Decision (EU) 2017/2441 of 21 December 2017 on the equivalence of the legal and supervisory framework applicable to stock exchanges in Switzerland in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L344/52.

[35]See Commission Implementing Decision (EU) 2017/2320 of 13 December 2017 on the equivalence of the legal and supervisory framework of the United States of America for national securities exchanges and alternative trading systems in accordance with Directive 2014/65/EU of the European Parliament and of the Council [2017] OJ L331/94.

stability or market integrity within the internal market. […] In this context, factors such as the size of the relevant market, the importance for the functioning of the internal market, the interconnectedness between the markets of the third country and the EU, or the risks of circumvention of EU rules may play a role. The Commission also needs to factor in wider external policy priorities and concerns in particular with respect to the promotion of common values and shared regulatory objectives at international level. All these factors are indicative of the amount of risk to the financial stability or the need for adequate protection of financial market participants and other persons in the EU.' [36]

It also emphasised that 'it follows a risk-based approach and the principle of proportionality'.[37] These statements indicate that fears that the Commission may refuse to grant equivalence to UK firms post-Brexit or withdraw such equivalence in a totally arbitrary manner are exaggerated.

However, references to the size of the relevant market, the interconnectedness between the third country and the EU and the risk posed to financial stability in the EU suggest that there may be some unpleasant surprises for the UK. The UK's financial market is huge by EU standards, highly interconnected to the EU market and a systemic crisis in the UK would significantly reduce financial stability in the EU. These factors weigh negatively in the context of equivalence decisions which means that the Commission is likely to scrutinise the UK regime most carefully before making any equivalence determination. Even if the UK maintains full alignment with relevant substantive EU rules, this does not mean that the Commission will be automatically satisfied, as the ambit of its scrutiny also includes robust supervision and related enforcement. It is worth noting that a refusal to grant equivalence or a revocation of equivalence on ostensible grounds of protecting financial stability is very difficult to be challenged successfully at the fora of the

[36]See Commission, 'EU equivalence decisions in financial services policy: an assessment' (Staff Working Document) SWD (2017) 102 final, 9-10.
[37]Ibid, 8.

World Trade Organisation as contrary to GATS.[38] This means that WTO law offers little effective protection for the UK in this area. Furthermore, there is currently pressure from the French Financial Markets Authority for the EU to tighten its MiFID equivalence regime in view of Brexit.[39] In particular, the French Authority emphasised the need for EU law to require firms from third countries which have achieved equivalent status to apply the MiFID rules on investor protection and market integrity, and the need to give ESMA a power to supervise third country firms that benefit from equivalence.

The preceding analysis suggests that the current regime on equivalence may well provide market access for UK financial firms in several areas, but will not attain the level of legal certainty that firms require.[40] This can only be achieved if an appropriate governance framework is put in place in the lines proposed by the UK Government. However, for the time being at least, the EU appears unlikely to consider entering into such an agreement with the UK as it views such a prospect as undermining the Single Market. This is not to say that in the long-term some institutional framework may not arise, especially one based on informal cooperation rather than hard law.[41]

In the meantime, however, the UK financial services sector will continue to

---

[38]See LANG, 'The 'Default Option'? The WTO and Cross-Border Financial Services Trade after Brexit' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Oxford: Hart Publishing 2018) 211-215.

[39]See OPHÈLE, Chairman of the French Financial Markets Authority , 'From Brexit to financial innovations: new challenges for financial regulation' (Speech at the Official Monetary and Financial Institutions Forum, London, 15 March 2018), available at https://www.amf-france .org/en_US/Actualites/Prises-deparoles/Archives/Annee2016?docId=workspace%3A%2F%2FSpa cesStore%2F02d32070-8a04-434a-a237-5b402bbf7139, accessed 6 August 2018.

[40]For instance, a recent House of Lords report concludes that the equivalence framework on its own would not provide a reliable foundation for the relationship between the UK and EU financial markets in for the long-term. See European Union Committee, *Brexit: the future of financial regulation and supervision* (HL 2017-19, 66).

[41]An in-depth exploration of potential models can be found in Eilis Ferran, 'Regulatory Parity in Post-Brexit UK–EU Financial Regulation: EU Norms, International Financial Standards or a Hybrid Model?' in Kern Alexander and others (eds), *Brexit and Financial Services: Law and Policy* (Hart Publishing 2018) 15-28. Regarding the feasibility of reaching a workable solution Ringe has optimistically asserted that a workable solution is highly likely to be found despite prevailing rhetorics on both sides as it is in the economic interest of both. See RINGE, 'The Irrelevance of Brexit for the European Financial Market' (2018) 19(1) *European Business Organization Law Review*, 1.

face the threat of losing business and jobs to the rest of the EU. To be sure, only very few jobs have been already lost to the City,[42] as most firms have established branches or subsidiaries with minimal staff. This, however, could easily change in the near future.[43] At the same time, investment in the sector in 2017 fell in the UK, while it rose in the EU and particularly in France.[44]

4. From the above analysis it is evident that the Brexit referendum has revealed an important question, namely, how far is the current relationship between the UK and EU financial sectors from achieving fairness and equal access.[45] It is worth noting that Brexit has raised several questions such as how to regulate a single banking licence,[46] mutual recognition[47] and home country control. It also raised the question: how to regulate the EU requirements for equivalence determinations in the financial sector. On this point, it is important to understand the current developments of the Brexit negotiations and possible outcomes in the banking and financial transactions. As Moloney noted, 'the rise of technocracy is

---

[42]Estimates of the total number of jobs that will have been lost by 29 March 2019, the day of Brexit, put the figure at around 10,500. See Ben Chapman, 'Brexit: UK to lose 10,500 City jobs as 30 per cent of firms flag plans to move staff' *Independent* (London 11 December 2017), available at https://www.independent.co.uk/news/business/news/brexit-latest-news-uk-city-job-losses-move-eu-frankfurt-paris-luxembourg-banks-europe-sam-woods-a8104176.html, accessed 6 August 2016.

[43]Senior officers in the Bank of England have been reported to have estimate that in the long-term 75,000 jobs could be lost. See Kamal Ahmed, 'Bank of England believes Brexit could cost 75,000 finance jobs' *BBC News* (London 31 October 2017), available at https://www.bbc.co.uk/news/business-41803604, accessed 6 August 2016.

[44]According to EY research foreign direct investment in the UK financial services sector reduced by 26% in 2017 while it grew by 13% in the EU as a whole. See ALI, 'We now need decisive action to prevent Brexit uncertainty from damaging the UK's status as Europe's leading financial services hub' (EY Report, June 2018), available at https://www.ey.com/uk/en/issues/business-environment/ey-attractiveness-survey-2018-uk-fs, accessed 6 August 2018. In addition, London has for the first time being surpassed by Paris as the most attractive city for foreign direct investment in the sector. See EY, 'Game changers EY's Attractiveness Survey Europe June 2018' (2018), available at https://www.ey.com/gl/en/issues/business-environment/ey-attractiveness-survey-europe-june-2018, accessed 6 August 2018.

[45]See REYNOLDS and DONEGAN, 'Brexit—Opportunity for a Reboot of Financial Regulation' (2016) 31(12) *Journal of International Banking Law and Regulation*, 613.

[46]The single banking license was introduced by the Second Banking Directive (89/646/EEC) to provide access to EU financial institutions to do business with each other. In this way, credit institutions which are authorized to operate in any Member State are allowed to establish branches and to provide cross-border services throughout the community on the basis of the principle of home country supervision.

[47]Mutual recognition means harmonization of a managed regulatory system. It implies mutual trust and adoption of common rules.

therefore likely to be the most significant influence on how EU financial governance develops over the period when the UK leaves the EU'.[48] In this context, the impact of Brexit would affect certain pieces of EU legislation such as the regulation of credit rating agencies (CRAs) and the special resolution regimes for failing banks.

This section focuses on the withdrawal of the UK from EU rules in the field of CRAs, as the UK leaves the Union according to Article 50 of the Treaty on EU. As the Commission recently warned, 'subject to any transitional arrangement that may be contained in a possible withdrawal agreement, as of the withdrawal date, the EU rules in the field of the Credit Ratings Agencies (CRAs) and in particular Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies ("CRA Regulation") no longer apply to the United Kingdom'.[49]

CRAs are financial intermediaries whose role is to promote market efficiency and efficient resource allocation. Their essential function is to address information asymmetries and assist investors in assessing the risk of default of financial products and issuers. A credit rating is a form of disclosure in which the financial conditions of companies are evaluated through opinions or forecasts about their relative stability.[50] The information provided represents a value for investors who rely on the credibility, transparency and independence of rating reports, although the certification and verification roles of CRAs leave doubts on the accountability regime in case of inaccurate assessments.[51]

CRAs have become major players in the financial markets yet their rep-

---

[48]See MOLONEY, 'EU Financial Governance after Brexit: The Rise of Technocracy and the Absorption of the UK's Withdrawal' in Kern Alexander, Catherine Barnard, Eilís Ferran, Andrew Lang and Niamh Moloney (eds.), *Brexit and Financial Services. Law and Policy* (Oxford: Hart Publishing 2018) 113.

[49]See European Commission, 'Notice to Stakeholders Withdrawal of the United Kingdom and EU Rules in the Field of Credit Rating Agencies', 8 February 2018, available at https://ec.europa.eu/info/sites/info/files/180208-notice-withdrawal-uk-credit-rating-agencies_en.pdf.

[50]See MACNEIL, 'Credit rating agencies: regulation and financial stability' in Thomas Cottier, Rosa M. Lastra and Christian Tietje (eds), *The Rule of Law in Monetary Affairs* (Cambridge: CUP 2014) 189.

[51]See COFFEE JR., 'Ratings Reform: The Good, The Bad, and The Ugly' (2010) European Corporate Governance Institute, Law Working Paper No 145, 29.

utations have been tarnished by certain assessments made during the 2007-09 financial crisis.[52] CRAs are capable of bringing about potential distortions in the financial sector, thereby resulting in a reduction in market confidence which, in turn, influences transactions and expectations.[53] Although several legislative reforms have been adopted globally[54] it can be argued that lack of rules of the game is the major factor in the accountability regime of CRAs. The problem is made worse by the fact that investors find it difficult to choose the right financial product because there is no appropriate system of disclosure and the internal control rules are inadequate. Market participants tend to mechanistically rely on ratings, thus causing hazardous behaviour such as sell-offs of securities when they are downgraded, the so-called 'cliff effects', that can contribute to procyclicality and systemic risk.

The regulatory framework of CRAs with regard to the reforms adopted in the UK and the EU highlighted a persistent gap in the supervision and enforcement of CRAs' activities.[55] Although the legislators have improved the monitoring system and increased the disclosure regime, particularly as a result of the direct and intrusive supervisory actions of ESMA in the EU,[56] the business conduct of CRAs has remained unaltered.[57] In this context, it has been noted that 'the current system for disclosing initial approaches by issuers of structured bonds is poorly

[52]See PAYNE, 'The Role of Gatekeepers' (April 2014) University of Oxford Legal Research Paper Series No 22/2014, 2, available at http://ssrn.com/abstract=2428121.

[53]See HISS and NAGEL, 'Credit Rating Agencies' in Daniel Mügge (ed.), *Europe and the Governance of Global Finance* (Oxford: OUP 2014) 140.

[54]See IOSCO Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies' (December 2004) 3; IOSCO, 'Code of Conduct Fundamentals for Credit Rating Agencies. Revised', May 2008; IOSCO, 'Code of Conduct Fundamentals for Credit Rating Agencies' (Revised March 2015) 3, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD482.pdf.

[55]See Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ 2009 L 302, p. 1); see also Regulation (EU) No 462/2013 (OJ 2013 L 146 p. 1).

[56]See European Securities and Markets Authority, 'ESMA's supervision of credit rating agencies, trade repositories and monitoring of third country central counterparties. 2017 Annual Report and 2018 Work Programme' (ESMA80-199-153), 8 February 2018, available at https://www.esma.europa.eu/sites/default/files/library/esma80-199-153_supervision_ar2017_and_wp2018.pdf.

[57]See DEIPENBROCK, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies – Some Critical Observations in a Broader Context' (2018) 29(2) *European Business Law Review*, 202-203.

designed to constrain ratings shopping'.[58] This means that investors find difficulties in accessing information about the relationships between CRAs and issuers.

The regulatory tools and oversight mechanisms over CRAs did not change the rating market, the conflicts of interest between raters and issuers or the limited competition creating barriers to entry for smaller rating agencies. This scenario could worsen in the aftermath of the Brexit referendum and the UK's withdrawal from the European Union: the possible dismantlement of EU legislation could leave CRAs activity in the UK completely unregulated, which would exacerbate the problems with the liability of rating agencies and the governance of the ratings industry.[59] In the post-Brexit scenario, the UK government might be moved to implement a new regulatory regime for CRAs, which could result in non-convergent rules for users of ratings and absence of adequate protection. The result of post-Brexit changes could be to undermine oversight over CRAs' activities and weaken supervisory practices: this in turn could lead to disruptive consequences, such as the deregulation of rating services and regulatory arbitrage.[60]

From a practical perspective, the Brexit implications on CRAs can affect the following aspects of rating governance: (1) deregistration; (2) use of ratings for regulatory purposes; (3) endorsement in a third country; and (4) prospectus disclosure.[61] In terms of deregistration, CRAs established in the UK will no longer be considered established in the EU. ESMA will therefore withdraw their registrations with effect on the withdrawal date according to Articles 14 and 20 of the CRA Regulation. This can have a major impact on the liability regime for CRAs since there can be a risk of regulatory arbitrage and an unequal playing field for the

[58]See POZEN, 'EU's attempt to tackle 'ratings shopping' is falling short' *Financial Times* (London, 14 June 2018). The author suggests that 'Esma should establish a central and accessible system of public disclosures on both initial approaches and final ratings by each EU issuer of a structured bond'.

[59]See BINHAM, 'Brexit casts doubt over rating agencies' future in London' *Financial Times* (London, 22 February 2017).

[60]See CASH, 'Credit Rating Agency Regulation in the UK If and When Article 50 is Invoked: Round Holes for a Square Peg?' (2018) 29(1) *European Business Law Review*, 71, where it is observed that Brexit in the ratings industry can spread the risk of regulatory arbitrage with the 'knock-on effect for the UK to weaken [the regulation] towards the CRAs in order to keep them operating, and contributing, within the UK'.

[61]See European Commission (n 49).

ratings industry.[62]

In relation to the use of ratings, if UK-based CRAs are deregistered by ESMA, EU investment firms will no longer be able to use ratings issued by these CRAs for regulatory purposes, such as Solvency II for insurance undertakings,[63] and CRR for credit institutions. This means that compliance with different regulatory regimes can create additional costs for investment firms, which are likely to be passed on to customers and retail investors. With regard to the endorsement question, ratings issued by a CRA established in a third country – which is part of a group to which a CRA established in the EU and registered by ESMA belongs – can be "endorsed" provided that certain conditions are met according to Article 4(3) of the CRA Regulation.[64] Under the prospectus head, according to Article 4(1) of the CRA Regulation any reference to a credit rating or credit ratings issued by a CRA established in the UK will need to include clear and prominent information stating that those credit ratings are not issued by a credit rating agency established in the EU and registered under the CRA Regulation. This is another example of regulatory uncertainty that will be manifested when the UK becomes a third country.

The material impact of Brexit on the regulation of CRAs will be made evident by the reshaping of competent supervisory authorities as ESMA will no longer have the responsibility for monitoring credit rating agencies in the UK and the Financial Conduct Authority will assume this role. In addition, the Brexit-era will be liable to exacerbate the heterogeneity of available remedies for investors seeking to hold CRAs liable as between the UK and the EU. Brexit may also have the effect

---

[62]On the liability regime for CRAs see PARTNOY, 'What's (Still) Wrong with Credit Ratings' (2017) 92(3) *Washington Law Review*, 1433; see also Matthias Lehmann, 'Civil liability of rating agencies—an insipid sprout from Brussels' (2016) 11(1) *Capital Markets Law Journal*, 61-62.

[63]See Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ 2015 L 12, p. 1).

[64]See Article 4(3) of the CRA Regulation provides that CRAs are endorsed if the conduct of the credit ratings activities by CRA established in a third country fulfils requirements which are at least as stringent as the EU specific framework, there is an objective reason for the rating to be elaborated in the third country and there is an appropriate cooperation arrangement between ESMA and the relevant supervisory authority.

of starting a debate about the importance of relying exclusively on market incentives for CRAs: in the event of a new UK regulatory framework, this may well provide for a higher level of immunity for rating agencies.

The uncertainties of Brexit may change the regulatory approach towards CRAs, entailing a risk of disruption in the ratings market. To the extent that Brexit will have an impact on CRAs, this can be seen as a missed opportunity to complete the process of harmonising the rules to which financial gatekeepers are subject. The next section discusses the potential implications of Brexit in the banking sector, namely the effects on the regulation of special resolution regimes for failing banks.

5. As previously discussed, after Brexit the UK will become a 'third country' within the current EU financial regulatory structure. This implies that future access to the EU's Single Market for UK-based financial institutions could be very limited. The uncertainty created in the aftermath of the Brexit vote is likely to affect the banking sector, particularly any plans among international banking groups to expand their UK-based operations. Most interestingly, there will be costs associated with the Brexit transition and 'most banks will be facing similar cost shocks, a large proportion of the additional costs are likely to be passed on to customers, rather than having a long-term impact on profitability'.[65] In this context, the post-Brexit scenario will determine the re-arrangement of special resolution regimes for failing banks regulated by the Bank Recovery and Resolution Directive (BRRD).[66] This section considers the implications of Brexit in dealing with failing banks and highlights the potential outcomes of implementing domestic regulatory tools to re-

[65]See DA SILVA, 'Leaving the EU: impact on bank customers', Oxford Law Faculty, Blog Series, 7 April 2017, 3, available at: https://www.law.ox.ac.uk/businesslawblog/ blog/2017/04/ brexitnego tiationsseriesleavingeuimpactbankcustomers.

[66]EU Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014. These resolution tools require the establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, OJ L 173 of 12 June 2014, p. 190.

solve fragile credit institutions.

It is worth noting that the BRRD and the Single Resolution Mechanism (SRM) form the new European regulatory framework of the bank insolvency regime.[67] The SRM introduced a centralised resolution in a single authority (Single Resolution Board) and a single set of resolution powers for failing banks. In the context of BRRD rules, bail-in is a key resolution instrument: the main rationale is to provide a mechanism to return an insufficiently solvent bank to 'balance sheet stability' at the expense of some of its creditors without the necessity of an external capital injection. Bail-in should have put an end to taxpayer-funded bank bailouts. However, the conditionality attached to the precautionary recapitalisation represents one of the major concerns in the current regulatory framework because of its interconnection with the provisions on State aid.[68] Recapitalisation could preserve financial stability—as a remedy to cover losses for failing banks—in the case of a rescue plan with strict conditionality guaranteed by a pool of investment banks.

The BRRD and SRM for Eurozone banks provide a framework for the resolution of banks that requires senior creditors to participate in losses, if necessary, instead of or ahead of a bank receiving sovereign support.[69] As a rule, group resolution efforts are to be coordinated by the consolidated group-level resolution authority, with only limited scope for independent resolution action by national

[67]The Single Supervisory Mechanism (SSM) has been established by Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287 of 29 October 2013, p. 63. The Single Resolution Mechanism (SRM) has been introduced by Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225 of 30 July 2014, p. 1.

[68]See GORTSOS, 'A Poisonous (?) Mix: Bail-Out of Credit Institutions Combined with Bail-In of Their Liabilities Under the BRRD – The Use of 'Government Financial Stabilisation Tools' (GFSTs)', paper presented at the Workshop of the Financial and Monetary Law Working Group of the European University Institute (EUI, Florence, 12 October 2016) on "Suitability of the new resolution regime for tackling systemic and structural crises in the banking sector – fine-tuning rules in transition", 6, available at https://ssrn.com/abstract=2876508.

[69]It is important to note that covered bonds are exempt from bail-in under BRRD and may benefit from resolution tools.

resolution authorities for individual group companies.[70] The BRRD contains strict legal provisions on loss absorbency in the form of bail-in of shareholders, creditors and depositors not protected by law (deposits exceeding €100,000) up to a maximum of eight percent of the institution's total assets, which in the past would have covered all eventualities.[71] The resolution authorities can decide to sell the bank as a going concern, create a bridge institution, hive off assets, and bail-in creditors. In addition, all Member States must set up national resolution funds with resources which after ten years must amount to one percent of insured deposits.[72] A similar fund accruing total resources of €55 billion will be set up for those banks in the Eurozone countries that are subject to the ECB's Single Supervisory Mechanism (SSM).[73]

The BRRD regulates recovery planning: institutions need to draw up and update recovery plans to (1) assess potential vulnerabilities; and (2) prepare measures to restore their financial position in case of "significant deterioration" of financial position. Recovery plans are based on various scenarios, including both idiosyncratic problems and market-wide stress, and are assessed by competent supervisory authorities, which may require amendments to remedy "material deficiencies". Articles 10-14 of the BRRD and Articles 8-9 of the SRM Regulation regulate resolution planning. In this context, resolution authorities need to draw up and update "resolution plans" to prepare swift and effective resolution action in case "conditions for resolution" under BRRD are met. In addition, resolution authorities of home and host countries need to develop "group resolution plans" to

---

[70]See BINDER, 'To Ring-Fence or Not, and How? Strategic Questions for Post-Crisis Banking Reform in Europe' (December 2014), available at: http://ssrn.com/abstract=2543860. See generally BRRD, articles 87 (general principles), 88 (resolution colleges), 91 and 92 (procedural and substantive requirements for resolution action in relation to groups). On the conditions for independent action by host authorities in this context, see articles 91(8) and 92(4).

[71]See KOKKORIS and OLIVARES-CAMINAL, 'Resolution of Banks and the State Aid Regime' in Jens-Hinrich Binder and Dalvinder Singh (eds.), *Bank Resolution: The European Regime* (OUP: Oxford University Press 2016) 304-305.

[72]See RAYMOND LABROSSE, OLIVARES-CAMINAL and SINGH, 'The EU bank recovery and resolution directive—Some observations on the financing arrangements' (2014) 15(3/4) *Journal of Banking Regulation*, 218-226.

[73]Specifically, 60 per cent of the fund's total resources will be paid in within the first two years; the fund is also authorized to borrow.

facilitate consistent approaches in the case of corporate groups.[74] Both the SSM and the SRM, within their respective mandates should be able to deal efficiently with the proliferation of cross-border banking and any possible negative implications. However, the EU mechanism for resolving failing banks is still a work in progress and needs to be fully tested. State level deposit insurers are not viable inside a monetary union because the liquidation of small banks could overwhelm the capacity of national deposit insurance. The full mutualisation of deposit insurance across the Eurozone requires full harmonisation of insolvency laws, because the effectiveness of the bank liquidation process will have an impact on the financial situation of each national deposit insurance authority, against which insured depositors have a legal claim.[75]

Converging towards a harmonised approach on recovery and resolution plans is the key issue at stake. As has been observed, ‘given that the barriers to cross-border banking are likely to fall, the EU should consider what sort of banking structure would provide the best combination of an integrated financial system and a financial system in which the banks are neither too large to supervise nor too large to safely fail’.[76] This means that rules will have an impact on where banks locate operations due to cost factors and that as a result risk will likely migrate to less regulated local subsidiaries. The rules contained in the BRRD are largely flexible to allow Member States to adopt the policy measures necessary to protect the public interest, even if the Directive does not define the boundaries of ‘public interest’ as a condition to provide public support.[77]

Withdrawal from the EU will allow the UK to adopt domestic policy measures to rescue distressed institutions. This will leave broad discretion to national competent authorities to provide public financial support and to implement

---

[74]Articles 15-16 of the BRRD introduce the “assessment of resolvability” with comprehensive powers to remedy impediments to resolvability under Articles 17-18 of the BRRD and Article 10 of the SRM Regulation.
[75]See NIETO and D. WALL, ‘Cross-Border Banking on the Two Sides of the Atlantic: Does it Have an Impact on Bank Crisis Management?’, FRB Atlanta Working Paper No. 2015-11, 19.
[76]Ibid., 21.
[77]See MICOSSI, Ginevra Bruzzone and Miriam Cassella, ‘Fine-tuning the use of bail-in to promote a stronger EU financial system’, CEPS Special Report No. 136, April 2016, 16-17.

restructuring tools, namely bail-in, precautionary recapitalisation and resolving plans. Brexit can compound the risk of deregulation for restructuring troubled banks: this complicates meaningful cross-border recognition when it comes to resolution or consolidated supervision.[78] It is instructive that the European Banking Authority (EBA) has warned that 'institutions and authorities need to assess their stock and issuance plans for instruments used to meet the minimum requirement for own funds and eligible liabilities (MREL) in the light of Brexit, and in particular their reliance on instruments issued under English law'.[79] This means that EU banks in the Eurozone will not be able to utilise any of their English law bail-inable debt toward their pending regulatory requirements if no Brexit agreement is reached.[80] In addition, as the EBA has pointed out, the Deposit Guarantee Scheme (DGS) shall ensure the adequate protection of Member States 'by assessing (where relevant) the equivalence of the UK's deposit protection regime at the date of Brexit, and should consider putting in place cooperation arrangements with the UK DGS after Brexit'.[81]

In the short term, the UK regime will continue applying existing domestic legislation for bank insolvency (e.g. the Banking Act 2009 that substantially anticipated the BRRD with respect to recovery and resolution plans).[82] As Mayes claimed, 'the resolution of the UK's banks will remain the responsibility of the Bank of England and purely national concerns will come first'.[83] Specifically, in terms of investment bank insolvency rules, Section 233 of the Banking Act 2009

---

[78]See CAPRIGLIONE, 'UK Referendum and Brexit Hypothesis: The Way Out Perspective and the Convenience to 'Remain United' (2016) 27(7) *European Business Law Review*, 893-895.

[79]See EBA, Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union (EBA/OP/2017/12), Part IV Resolution and deposit guarantee schemes, 12 October 2017, 16.

[80]See BIPPART, 'English-law bonds could be excluded from MREL post-Brexit', Euromoney, 24 November 2017, available at https://www.euromoney.com/article/b15rkx7999nk36/regulation-english-law-bonds-could-be-excluded-from-mrel-post-brexit.

[81]See EBA (n 79) 16. In terms of recovery and resolution plans, the EBA clarified that 'once the UK leaves the EU, arrangements for resolution planning for entities based in the UK should be subject to the same standard as for any other third country, in the absence of an agreement to the contrary'.

[82]See Part II ('Bank Insolvency') of the Banking Act 2009.

[83]See MAYES, 'Banking union: the disadvantages of opportunism' (2018) 21(2) *Journal of Economic Policy Reform*, 136-137.

provides that 'in making investment bank insolvency regulations the Treasury shall have regard to the desirability of—(a) identifying, protecting, and facilitating the return of, client assets; (b) protecting creditors' rights, (c) ensuring certainty for investment banks, creditors, clients, liquidators and administrators, (d) minimising the disruption of business and markets, and (e) maximising the efficiency and effectiveness of the financial services industry in the United Kingdom'.[84]

Over time divergences may appear and in fact new rules may be introduced to exploit new markets. As observed, 'a clear danger with adopting an early intervention model is still the timing issue, so whether a rules-based or a discretion-based approach is taken, its success will depend on its use and the timing, and not necessarily what shape it takes'.[85] However, the Banking Act 2009 faced criticism on the fact that it has the potential to cause significant interference with the rights of third parties, both by prohibiting the exercise of termination rights under a contract and, more generally, through the way that the assets and liabilities of an ailing bank are split.[86] One can argue that Brexit could determine the increase in the complexities of resolution for groups that operate in the UK and rest of the EU, particularly if rules diverge. This could lead to conflicting resolving decisions on the applicable restructuring tool for failing banks: the application of the Banking Act 2009 can create inconsistency with other jurisdictions making these divergences challenging to resolve, particularly in the post-Brexit scenario.

6. By way of conclusion it is worth reflecting on the likely future directions of UK financial regulation. The preceding analysis highlights the vital importance for UK firms of retaining alignment with EU financial legislation in order to maximise the chances of equivalence determinations. After Brexit, the UK will become a 'third country' within the current EU financial regulatory structure, which implies

[84]Section 233 ('Insolvency regulations') of the Banking Act 2009.

[85]See SINGH, 'The UK Banking Act 2009, pre-insolvency and early intervention: policy and practice' (2011) 1, *Journal of Business Law*, 42.

[86]See HEARNDEN and WHITFIELD, 'The Banking Act 2009' (2009) 3 *Corporate Rescue and Insolvency*, 96.

that future access to the EU's Single Market for UK-based financial institutions may be very limited. The uncertainty created in the aftermath of this controversial vote is likely to affect any plans among international financial institutions to expand their UK-based operations. In addition, the impact of Brexit would affect transaction costs as financial regulation can diverge from the EU legislative framework. There is little doubt that the UK will continue to comply with MiFID/MiFIR and all other market infrastructure directives and with Directives on banking and insurance prudential regulation. However, this is not to say that there will not be areas where the UK approach may diverge from EU law post-Brexit. The regulation of CRAs and bank resolution are two such areas in which, as explained in this article, possible divergence of the UK from the EU framework and lack of cooperation post-Brexit pose serious risks for regulatory effectiveness and may create additional costs for financial institutions, which are likely to be passed on to retail investors and customers.

FROM THE FISCAL BACKSTOP TO THE ESTABLISHMENT OF A DEPOSIT GUARANTEE SCHEME: THE ROAD TOWARDS A FULLY-FLEDGED EUROZONE *

Giuseppe Sciascia** - Dalit Flaiszhaker ***

ABSTRACT: *The paper addresses the issues of the completion of the European Banking Union and the so called "deepening" of the Economic and Monetary Union. The proposals on the establishment of a European Monetary Fund seeks to fully absorb the ESM within the institutional architecture of the economic governance of the EU, thus enhancing the decision-making role of the Council and extending the capacity of the fund to provide support to the SRB in case of systemic banking crises. Alongside this ambitious and controversial project, negotiations on the proposal submitted by the European Commission to complete the Banking union through the establishment of a deposit insurance scheme as a complement to the SSM and the SRM are still underway, following the political auspice to pursue a further reduction of banks' balance sheet credit risks - an overwhelming legacy of the global financial crisis. By providing a review of the rationales of the two proposals, the paper discusses the features of the latter, underlining the key interlinkage existing between the EMU and the EBU and the need to jointly address the existing gaps.*

---

*The views and opinions expressed herein belong only to the Authors and neither involve nor represent the positions of any affiliated institution.

**Ph.D. candidate at the University of Rome - Sapienza and Expert at the Directorate General for Financial Regulation and Supervision of the Bank of Italy.

***Ph.D. candidate and research fellow at the Zvi Meitar Center for Advanced Legal Studies, Tel-Aviv University, and a junior researcher in the Financial Division of the Bank of Israel Research Department.

schemes regulation. – 3.2. The proposal on a European Deposit Insurance Scheme (EDIS): features and challenges. – 4. Closing remarks.

1. Despite multiple appeals to swiftly act, the path towards the completion of the European Banking Union (EBU) and the deepening of the Economic and Monetary Union (EMU) proceeds at slow pace. A fierce political debate underlining the divide among national and European polities hangs over the two key missing pieces of the most ambitious projects of European economic and financial integration: on the one hand, the so called "fiscal backstop" - or, more generally, the "backstop facility" - aimed at shielding the Single Resolution Fund (SRF) in case of implementation of expensive resolution plans and fully supporting Eurozone sovereign debts at risk beyond the current European Stability Mechanism (ESM); on the other hand, the common deposit insurance scheme for credit institutions headquartered in the Eurozone, understood as third pillar of the EBU following the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), and already foreseen by the European Commission (EC) in its original 2012 roadmap[1].

Against the background of this long-standing dispute, Europe suffers a broader stall in its effort towards a further democratic integration to the benefit of its citizens. The multiple crises that lap the European borders push for a progressive seclusion within domestic boundaries[2]: fractures between the North and the South, as well as the East and the rest of the Union, revamp ranting populisms and an unprecedented madden against Bruxelles, channeled and amplified

[1]European Commission, *Communication to the European Parliament and the Council. A roadmap towards a Banking Union*, COM (2012) 510 final, where it was notably remarked that «(s)*hifting the supervision of banks to the European level is a key part of this process, which must subsequently be combined with other steps such as a common system for deposit protection, and integrated bank crisis management*».

[2]For an account of the various crises which impacted Europe during the last ten years, see the remarkable contributions in the issue no. 3/2016 of the Rivista Trimestrale di Diritto Pubblico; in particular, FABBRINI, *La crisi dell'euro e le sue conseguenze*, 651; CASSESE, *«L'Europa vive di crisi»*, 779; VESPERINI, *La crisi e le nuove amministrazioni*, 695; PINELLI, *Il doppio cappello dei governi fra Stati e Unione europea*, 639. For a focus on the EMU, see also *S. Fabbrini*, *Which European Union? Europe After the Euro Crisis*, Cambridge, Cambridge University Press, 2015.

through the innovative capacity of new media. The worrying reemergence of national selfishness frustrates any momentum towards the establishment of a true European polity, entrenching with the difficult quest for a rationalized economic governance: as remarked by Habermas, «the general trend towards xenophobia and nationalism caused by economic uncertainty and growing cultural pluralism has acquired explosive force within the EU, and especially within the Eurozone»[3]. As a result, the «unprecedented challenge to the values of openness, internationalization, liberal democracy, market social economy» faced by Europe[4] still misses an inclusive and comprehensive response, while pronouncing «the F-word» still appears simply unbearable[5].

With a view to contribute to the current debate on the future of the EU and the economic projects of integration still at its core, this paper provides an overview of the features of a common backstop for the Eurozone and of the European Deposit Insurance Scheme (EDIS) for the EBU under discussion. The analysis intends to reflect on two aspects of the foreseen proposals: the evolving role of both the Council and the latest generation of EU agencies in decision-making processes related to financial stability issues; the difficult equilibrium between technique and politics in the governance of private and sovereign finance within the reach of the single currency[6].

The analysis is structured as follows.

Paragraph two discusses the rationale for a fiscal backstop in the Eurozone and the main features of a recent proposal submitted by the EC on the creation of a European Monetary Fund (EMF). Paragraph three addresses the establishment of a deposit guarantee scheme within the EBU; to this end, a basic overview of the general aspects of deposit protection mechanisms is provided, followed by a dis-

[3]See HABERMAS, *Democracy in Europe: Why the Development of the EU into a Transnational Democracy Is Necessary and How It Is Possible*, in European Law Journal, 2015, 546, 549.
[4]See MICOSSI, *What is next for Europe?*, in Law and Economics Yearly Review, 1, 2017, 74.
[5]See CONRAD, STEINGRIMSDOTTIR, *F-Word or Blueprint for Institutional Reform? European Integration and the Continued Relevance of Federalism*, in Icelandic Review of Politics and Administration, 2012.
[6]For a recent account of the issues at stake, see CAPRIGLIONE, SACCO GINEVRI, *Politics and finance in the European Union*, in Law and Economics Yearly Review, 1, 2015, 4, spec. 53 ff.

cussion of the content of the proposal advanced by the EC in 2015 on the EDIS. Paragraph Four provides some final comments on the themes at the center of the paper, contending the need for breaking some interconnected «dooming loops» which impede to reach the goal of completing the integrated pillars of the EBU and the EMU.

2. The need for a common backstop aimed at ensuring financial stability in the Eurozone is commonly acknowledged by EU policymakers and academics.

Among the first, two notable proposals advanced in the last three years represent the current basis for debate.

In 2015, the well-known "five Presidents report" on the deepening of the EMU called for the establishment of a «a credible common backstop to the [SRF] […] [, to] be done through a credit line from the [ESM] to the [SRF]», and to be set-up as «fiscally neutral over the medium term by ensuring [...] ex post levies on the financial industry»[7]. The wording of the report essentially mirrored a nearly contemporary reflection paper of the EC on the completion of the EMU, where EU Member States were called to swiftly agree «on a common backstop for the Single Resolution Fund which should be fiscally neutral over the medium term»[8].

In 2017, the latest communication by the EC on the completion of the EBU took hence on board the proposal of the five presidents and called for a tool seeking «to instill confidence in the banking system by underpinning the credibility of actions taken by the [SRB] and ensuring that those actions enjoy absolute confidence among all parties concerned», *i.e.*, a last resort instrument to be activated only in case «the [SRF]'s immediately available resources prove to be insufficient for capital or liquidity purposes»[9].

---

[7]Five Presidents' Report: Completing Europe's Economic and Monetary Union, 22 June 2015.
[8]See European Commission, *Communication from the Commission to the European Parliament, the Council and the European Central Bank On steps towards Completing Economic and Monetary Union*, COM (2015) 600 final, 21 October 2015, 13.
[9]See European Commission, *Communication to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on completing the Banking Union*, COM (2017) 592 final, 13-14.

In an attempt to stimulate a political compromise, several prominent scholars supported the establishment of such a common backstop, while providing different rationales and views on its features and scope.

Among others, Gros and Meyer[10] argued in favor of a scheme capable to deal with sovereign defaults in the EMU and designed with specific features preventing moral hazard, provided that «without such a mechanism, debtor countries facing painful adjustment programmes retain their main negotiating asset, namely the threat of a disorderly default, creating systemic financial instability at the EU and possibly global level»[11]. By taking a more focused EBU-perspective, Messori and Barucci noted that the SRF is currently ill-equipped to cope with a systemic financial crisis in light of the extensive constraints which disincentivize its use, thus stressing that «a complete and satisfying working of the SRM asks for the presence of a common backstop, sufficiently strong to face systemic shocks»[12]. In a rather different vein, Avgouleas and Goodhart claimed the benefits of a euro-wide fund backed by an ESM guarantee to tackle the issue of high non-performing loans (NPLs) levels in Eurozone banks and free up capital for boosting economic recovery in the periphery of the single currency area[13].

As noted by such a brief review, there is a substantial consensus on the need for a redefinition of the current incomplete architecture of the EMU and the EBU with a view to achieve one final goal and two strictly intertwined intermediate objectives. The general goal is to ensure (the broad and intangible interest to) financial stability, understood as a state whereby the risk that the provision of

---

[10]See, *inter alia*, MAYER, *The case for a European Monetary Fund*, Intereconomics, May/June 2009, 136; GROS, MAYER, *How to deal with sovereign default in Europe: Create the European Monetary Fund now!*, CEPS Policy Brief No. 202, CEPS, Brussels, February-May 2010; Id., *How to deal with sovereign default in Europe: Towards a Euro(pean) Monetary Fund*, Report requested by the European Parliament, 2010; Id., *EFSF 2.0 or the European Monetary Fund*, CESifo DICE Report, Ifo Institute for Economic Research at the University of Munich, 2011, 31; GROS, *Transforming the ESM into an EMF as Part of the IMF*, in A. Lamfalussy, B. Snoy, M. Dumoulin (eds), *In Search of a New World Monetary Order*, London, Peter Lang Publishers, 2013.

[11]See GROS, MAYER, *How to deal with sovereign default in Europe*, cit., 2.

[12]See BARUCCI, MESSORI, *Is the Single Resolution Fund an effective backstop?*, in Id. (eds.), *Towards the European Banking Union. Achievements and open problems*, Passigli - Astrid, 2014.

[13]See AVGOULEAS, GOODHART, *An Anatomy of Bank Bail-Ins. Why the Eurozone Needs a Fiscal Backstop for the Banking Sector*, in European Economy, 2016, 2, 75.

necessary financial products and services by the financial system will be impaired to a point where economic growth and welfare may be materially affected is prevented[14]. The two intermediate objectives to be achieved through a common backstop are those of *i)* effectively backing the use of the SRF in case of a systemic banking crisis so as to support the pursue of resolution objectives codified within the SRM/BRRD framework, and *ii)* ensuring recourse to a pool of readily available funding resources for Eurozone sovereigns facing difficulties to access global markets.

In order to further deepen the analysis of the terms of the ongoing debate, in the next sub-paragraph we discuss the rationale for the establishment of a common backstop in the EMU by moving from the problem of attaining financial stability in a single currency area.

To this end, two key elements should be already beard in mind: the first is the well-known need to break the "vicious circle"[15] among sovereigns and bank in the Eurozone, a recurring theme in the discussion surrounding the broader reform of the economic governance of the EU, and already a major rationale for the establishment of the first two pillars of the EBU; the second point is the lack of a central bank backstop in the Eurozone stemming from the renown Treaties constraints, which implies that States seeking access to financial markets are broadly left to their own devices in the absence of a European trouble-relief system, including when acting to support the banking system in case of looming systemic risk.

2.1 From the discussion above, we conclude that a public backstop facility can be understood as a pool of monetary resources to be used in case of impend-

[14]We build upon the definition adopted by the ECB in its Financial Stability Review. See, ECB, *Definition of financial stability*, in www.ecb.europa.eu/ecb/tasks/stability/html/index.en.html.

[15]This expression was notably used for the first time in the Communication from the Commission to the European Parliament and the Council, *A Roadmap towards a Banking Union*, where it was stressed that «(f)urther steps are needed to tackle the specific risks within the Euro Area, where pooled monetary responsibilities have spurred close economic and financial integration and increased the possibility of cross-border spill-over effects in the event of bank crises, and to break the link between sovereign debt and bank debt and the vicious circle which has led to over €4,5 trillion of taxpayers money being used to rescue banks in the EU».

ing risks for financial stability and exhaustion of other precautionary lines of defense. In this regard, it constitutes a key part of the *safety net*, namely «a diverse set of institutions and mechanisms which can contribute to preventing and mitigating the effects of economic and financial crises»[16]. Recalling a more appealing metaphor, such "net" is a texture preventing a sudden crash to the ground of something likely or prone to fall – as the financial system is functionally and structurally inclined to.

As long as crises do not have the same origin, magnitude and duration, the components of the safety net have different scope, features, rules, incentives and objectives. These have been historically and chaotically built-up in several domestic and supranational layers, thus giving rise to somewhat different institutions and tools. The natural complexity of safety nets stemming from the fragmentation of sovereign States and their interconnection within global markets has been further complicated in the EU through the establishment of a mixed regional governance framework, which shows different and inconsistent asymmetries and degrees of integration.

In general terms, four key components of modern safety nets with both a preventive and corrective component can be identified: *i)* an institutional and technical framework grounded on an independent central bank and designed to attain price stability and prevent temporary shortenings of liquidity; *ii)* a regulatory and supervisory framework aimed at ensuring the effective functioning of the banking and financial system and the maintenance of its ability to provide core economic functions; *iii)* a specific framework for banking crises, mainly including deposit insurance schemes to prevent bank runs (see, *infra*, § 3.1) and a special regime for insolvency management and loss-coverage financing; and *iv)* sound fiscal policies preventing, *inter alia*, balance of payments crises, along with adjustment programmes capable to pool resources to service external sovereign debt.

---

[16]See ECB, *The layers of the global financial safety net: taking stock*, in ECB Economic Bulletin, Issue 5/2016.

With the sole exception of the component under point *ii)* above, the idea of "backstop facility" recurs in all the mentioned parts of the safety net. Indeed, when referring to the central bank role sub *i)*, it recalls the temporary actions to sustain banks in need for liquidity through last resort lending, also known as emergency liquidity assistance (ELA). Under point *iii)*, the backstop is embedded in the mentioned mechanisms of deposit insurance schemes and so called "resolution funds", being the former aimed at swiftly compensating depositors and the latter at providing financing to restore failed banks' viability and/or compensate losses. Finally, point *iv)* raises the issue of bilateral and/or multilateral arrangements among sovereigns, traditionally established to hamper the effects of balance of payment crises potentially harmful for the whole global stability in the aftermath of Bretton Woods.

Moving to the current (regional) framework of the EMU, one should note that the safety net and its common backstop components are currently dispersed in a wide variety of national, *intra*-EU and *extra*-EU constituents. Their degree of centralization varies significantly, thus giving rise to a baroque architecture. The latter points out the existence of coordination problems among the numerous actors involved and the recurring pressure on MSs to cope with severe banking crises, as it can be drawn from what follows.

To summarize, the current ELA mechanism in the Eurozone is based on the role of the ESCB, whereby MSs' central banks might exercise their power to provide last resort lending within a specific common framework agreed with the ECB. Similarly, banking crises management is only partially centralized: the SRM and its SRF provide a framework for resolution of systemic banks within the EBU under the responsibility of the SRB, while rules on deposit coverage are harmonized to a maximum possible extent in the whole single market and subject to a loose oversight role of the EBA (see, *infra*, § 3); nonetheless, despite significant cross-border integration of financial activities, deposit guarantee schemes are still national-based, while the SRF is still undergoing construction and national funds (including last resort taxpayers' ones) currently represent the bulk of readily available resolution resources. At its turn, fiscal policy is subject to preventive and corrective mechanisms which basically provide a stringent (but difficult to enforce) coordination system of economic governance, while under exceptional circumstances a formally extra-ordinem intervention by the ESM might be provided to protect Eurozone financial stability. Finally, regulation and supervision show the highest level of centralization, following the taking up of a substantial primary and secondary regulatory role by the EC and the EBA for the Single Market as a whole, and the launch of the SSM as first pillar of the EBU.

Against this background, economic scholars clearly stressed the need for a common backstop when contending the establishment of a fiscal union within the single currency area. Provided that «monetary policy and exchange rate flexibility typically play a critical role in countering country-level shocks», Berger et al. noted that «within a currency union - where the common monetary policy focuses on the currency union aggregate - […], fiscal policy needs to play a greater role in absorbing country-level shocks»[17]; in particular, «a sovereign's inability to deal with the consequences of a systemic banking crisis may even challenge the integrity of the single currency. A powerful sovereign-bank nexus in EMU magnifies problems that the lack of fiscal risk sharing causes. The health of banks and sovereigns is linked by multiple interacting channels […] These linkages, present in every country, become a greater concern in the context of a currency union, where monetary policy cannot react to individual country shocks. The bank-centered nature of the euro area financial system adds vulnerability, with the crisis showing how some banking systems are now large enough to threaten government solvency»[18].

As part of the safety net, a common backstop stems from the fact that crises affecting banks tend to be systemic and related to macroeconomic trends, which imply, and at their turn exacerbate in a diabolic loop, market collapses and economic downturns. In this regard, as the first lines of defense like resolution

[17]See BERGER, DELL'ARICCIA, OBSTFELD, *Revisiting the Economic Case for Fiscal Union in the Euro Area*, IMF, Departmental Paper Series Research, 2018, 10.
[18]Ibidem.

funds and deposit guarantee schemes might run out of money due to deteriorating environmental conditions, «(t)he ultimate backup of government support is needed to give […] credibility»[19].

From the above we conclude that the current architecture of the EMU safety net lacks some of the basic features which are truly needed to ensure financial stability in a single currency area. On the one hand, a variable degree of centralization impacts several key nodes of the safety net, increasing pressure on sovereigns to intervene when risk is close to materialize. On the other hand, the lack of MSs' management of monetary flows, along with budgetary surveillance as well as rules on State aids represent a *de facto* limit of MSs' power of intervention which is not adequately balanced at European level.

The next paragraph will now move to discuss the main features of the proposal laid down by the EC for the establishment of a common backstop in the Eurozone, *i.e.*, a European Monetary Fund (EMF) to replace the ESM and fully absorb it in the EU institutional landscape. The analysis will later address a different albeit important part of the safety net, *i.e.*, the common deposit guarantee for the EBU.

2.2 In December 2017, the EC delivered a proposal for a Council Regulation on the establishment of the EMF[20]. Remarkably, the plan is part of a broader package of foreseen reforms put forward by the EC to complete the EMU framework. Such broader project includes *i)* a Communication "*on new budgetary instruments for a stable euro area within the Union framework*"[21], *ii)* a Communication on "*a European Minister of Economy and Finance*"[22], *iii)* a proposal for a Council Directive aimed at integrating the so called Fiscal Compact (*i.e.*, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union)

---

[19]See SCHOENMAKER, GROS, *A European Deposit Insurance and Resolution Fund*, CEPS Working Document no. 364/May 2012, 2.
[20]See European Commission, *Proposal for a Council Regulation on the establishment of the European Monetary Fund*, COM (2017) 827 final.
[21]See COM (2017) 822, final.
[22]See COM (2017) 823 final.

within the EU legal framework[23], and *iv)* two proposals for amending EU Regulations laying down the general framework for structural reform support to EU Member States (*i.e.*, Regulation (EU) 1303/2013, and Regulation (EU) 2017/825)[24].

The proposed Regulation (hereinafter, the "EMF Regulation") seeks to establish a Fund to replace the current ESM framework and overcome its (partially) *extra-ordinem* nature. To this end, the Regulation is complemented by an Annex which sets out the Statute of the Fund largely building upon the current ESM one as enshrined in its founding treaty. As remarked in Article 2 of the EMF Regulation, the Fund shall indeed «succeed to and replace the European Stability Mechanism», thus assuming all of its rights and obligations according to a process to be completed upon the entry into force of the Regulation itself or upon consent of the ESM, whichever the latest. In addition, a draft intergovernmental agreement among Eurozone MSs to approve the transfer of funds from the ESM to EMF is attached to the proposal.

Before presenting a quick overview of the content of the proposal, it is worth underlining the symbolic value of the name chosen by the EC. Indeed, the will to transform the «*stability mechanism*» in a (regional) «*monetary fund*» can be read as an attempt to ensure that any potential Eurozone rescue action would be independent from the influence of the International Monetary Fund (IMF), which played a prominent role in the management of EU sovereign debt crises thanks to its long-standing experience and operational capacity.

Nonetheless, the departure from a domain of the sole *global* backstop scheme of the safety net is not devoid of misleading implications. Indeed, as appropriately remarked by the ECB in its opinion on the EMF Regulation[25], «the use of the term 'monetary' in the new name of the Union body [...] is inaccurate, in particular as the objectives and tasks of the ESM are not 'monetary' in nature. In

[23]See COM (2017) 824 final.
[24]See COM (2017) 825 and 826 final.
[25]See ECB, *Opinion of the European Central Bank of 11 April 2018 on a proposal for a Regulation on the establishment of the European Monetary Fund*, CON/2018/20, in www.ecb.europa.eu/ecb/legal/pdf/en_con_2018_20_f_sign.pdf.

accordance with the Treaties, economic policy is based on the close coordination of Member States' economic policies, on the internal market, and on the definition of common objectives, while the basic tasks to define and implement the monetary policy of the Union and to conduct foreign exchange operations are conferred on the ESCB, which is governed by the decision-making bodies of the ECB»[26].

The ECB has a strong case for contending the appropriateness of the Fund denomination along with *Pringle*[27], where the European Court of Justice (ECJ) drew a neat distinction between the objective to be pursued by the ESM – *i.e.*, to safeguard the stability of the Euro area as a whole – and the objective to be pursued through the ESCB's monetary policy – *i.e.*, the maintenance of price stability. In this respect, the Court also remarked that an economic policy measure could not be regarded as equivalent to a monetary policy measure despite having indirect effects on the single currency and its steadiness. Therefore, we note that neither the implicit monetary dimension of the Fund nor the symbolic value attached to the will of setting aside the experience of the "Troika" can justify a misleading denomination, not to mention the rather different funding method which is expected to be used by the EMF when compared to the IMF[28].

Moving to the content of the EMF Regulation and the attached Statute, a number of important features shall be herein remarked. In particular, four aspects seem to deserve specific attention: *i)* the legal basis designated by the EC, *ii)* the tasks that the EMF is supposed to specifically undertake, *iii)* the structure and decision-making process, and *iv)* the political accountability of the Fund.

---

[26]Ibid, 5.

[27]See European Court of Justice, C-370/12, *Pringle*.

[28]In this regard, for a thorough comparative review of the ESM and the IMF, see European Parliament, *The ESM and the IMF: comparison of the main features*, April 2018. In addition to the issue mentioned in the text, the key differences between the current ESM and the IMF regard both the institutional architecture and operational capacity of the two mechanisms. For example, the ESM enjoys preferred creditor status towards its debtors albeit it is second to the IMF only. Divergencies can also be pointed out with regard to program monitoring, quotas and capital contributions, conditionality, limits on disbursements and ex-ante monitoring.

In the absence of a specific Treaty provision, the legal basis of the EMF Regulation is indicated in Article 352 of the Treaty on the functioning of the European Union (Tfeu). The latter can notoriously be activated whenever action by the EU is deemed necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the latter have not provided the necessary powers. Under a procedural perspective, the flexibility clause of Article 352 provides for a special enactment formula requiring the unanimity of the Council on the EC's proposal, the consent of the European Parliament as well as the involvement of (and potential approval by) MSs' parliaments[29].

The foreseen use of Article 352 has both an interesting historical and legal dimension. On the one hand, the flexibility clause was activated in several occasions during the construction of the EMU, including the management of the earlier balance of payments facilities, the establishment of the European Monetary Cooperation Fund, and the creation of the European Currency Unit[30]: there is hence a strong argument for supporting the *political* feasibility of the EMF through the subsidiary provision of Article 352, provided that such relevant precedents eventually prepared the ground for the single currency and the legal basis was deemed acceptable at the time. Furthermore, in the aforementioned *Pringle* case the ECJ itself implicitly recognized that the Union could have resorted to Article 352 Tfeu to set-up the ESM, when it pointed that «the Union has not used its powers under that article» although not being obliged to do so[31]; also, the Court recognized that the objective to be pursued by the ESM falls under the remit of economic policy (see *supra*), thus again confirming that its final goal of ensuring financial stability

[29]With particular regard to Germany, see the judgment of the German Constitutional Court of 30 June 2009 on the Lisbon Treaty, DE:BVerfG:2009:es20090630.2bve000208, paragraph 417: "*In so far as the flexibility clause under Article 352 TFEU is used, this always requires a law within the meaning of Article 23.1 second sentence of the Basic Law*"; for such cases, the German Constitution requires a two third majority in both the Bundestag and the Bundesrat. See, European Commission, *The role of the 'flexibility clause': Article 352*, in ec.europa.eu/ commission/sites/ beta-political/files/role-flexibility-clause_en.pdf, footnote 7.
[30]See European Commission, *The role of the 'flexibility clause'*, cit.
[31]See, *Pringle*, § 67.

constitutes an objective «*set out in the Treaties*» within the meaning of Article 352.

According to the proposed framework, the EMF will undertake two key tasks.

Firstly, the Fund will represent the much-welcomed common backstop to the SRF, thereby enhancing the latter's credibility and financial capacity. According to the EC, such backstop is indeed intended to «instill confidence in the banking system by underpinning the credibility of actions taken by the [SRB]. In turn, this would actually reduce the likelihood of a situation in which a backstop would be to be called on»[32]. To this end, the enabling clause is laid down in Article 22 of the proposed Statute, where it is stated that financial support to the SRB shall be jointly provided by the EMF and by the SSM participating Member States whose currency is not the euro, on equivalent terms and conditions, through credit lines or ceilings, or both, for guarantees on liabilities of the SRB. With a maximum initial ceiling set at 60 billion euros, the amounts of support provided to the SRB shall be borne in proportion to a key to be communicated by the SRB upon receipt of a support request, which will be calculated on the basis of the extraordinary ex-post contributions that would need to be raised in order to repay the total amount of support itself as further detailed in Article 22(1) of the Statute.

Secondly, the Fund will undertake the ESM responsibilities to carry out emergency support operations broadly within the previous framework laid down in the existing ESM Treaty. As a consequence, whenever *indispensable* to safe-guard the financial stability of the euro area or of its Member States, the EMF would be enabled to provide stability support to any Eurozone country through five main different schemes, and according to the additional guidelines to be adopted by its governing bodies: *i)* precautionary financial assistance[33]; *ii)* financial assistance for the re-capitalisation of credit institutions headquartered in the EMF

[32]See European Commission, *Proposal*, cit., 6.
[33]Precautionary financial assistance is provided in the form of a precautionary conditioned credit line or in the form of an enhanced conditions credit line in accordance with Article 12(1) of the Statute.

MS; *iii)* loans; *iv)* primary or secondary market support via purchase of EMF MSs' bonds; and *v)* instruments for the direct recapitalisation of systemic credit institutions[34].

Along with a well-established international practice, all support programs will be assisted by strict policy conditions to hamper moral hazard, which may range from the negotiation of a macro-economic adjustment programme pursuant to Regulation (EU) No 472/2013[35] to the continuous respect of pre-defined eligibility conditions. These preparatory activities will not be carried out by the Fund itself, but fully delegated to the EC and the ECB, save for a final endorsement through the signing of the agreement by the Fund.

An important aspect of the proposal on the EMF stemming from the transformation of the ESM in an *intra*-EU mechanism is represented by the significant changes to the decision-making processes. Indeed, while the governing structure of the Fund will substantially mirror the existing features of the ESM albeit with some adjustments called by the potential adhesion of non-Eurozone countries to the EBU, the most intriguing novelty is represented by the central role gained by the Council. Such an arrangement formally stems from the need to reconcile the features and tasks of the EMF with the well-known constraints posed by the "Meroni doctrine"[36]; at the same time, it clearly signals the unwillingness of Eurozone MSs to ultimately delegate or take decisions according to the communitarian method, also in the absence of a strong legal basis in the Treaties.

[34]See Article 19. According to the current wording of the proposed Statute, «(t)he assistance shall cater for specific cases in which the EMF Member experiences acute difficulties with its financial sector that cannot be remedied without significantly endangering its fiscal sustainability due to a severe risk of contagion from the financial sector to the sovereign or where other alternatives would have the effect of endangering the EMF Member's continuous market access». Furthermore, this type of assistance is limited to credit institutions of systemic relevance or which pose «a serious threat to the financial stability of the euro area as a whole or of the requesting EMF Member».

[35]See Regulation (EU) No 472/2013 of the European Parliament and of the Council of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability.

[36]This renown doctrine limits the extent to which EU institutions may delegate their tasks to regulatory agencies, and it stems from two cases decided by the European Court of Justice in 1956 (C-9/56 and C-10/56, *Meroni v. High Authority*).

Under an organizational perspective, the proposal confirms the existing two-tier system of the ESM: the fund will hence be managed by a Board of Governors and a Board of Directors, while an important role will be also awarded to the Managing Director. The first body will substantially have the same membership of the Euro Group: indeed, the governors will be the members of EMF MS governments in charge for financial affairs, while the chairperson will be the President of the Euro Group itself; furthermore, a member of the Commission and the President of the ECB will participate to the meetings of the Board as non-voting members. Members of the Board of Directors will be appointed by each governor from among people of high repute and competence in economic and financial matters; along with them, the EC and the ECB will be entitled to respectively appoint one non-voting member and one observer.

The Managing Director will be appointed by the Council, upon consultation with the European Parliament, among nationals of EMF MS with relevant international experience and a high level of expertise in economic and financial matters; the appointment is approved with a qualified majority of the votes of MSs whose currency is the euro, which are the sole entitled to cast a vote. The Managing Director will ensure the effective functioning of the Fund, and he/she will also take a leading role in ensuring its external accountability vis-à-vis European and national institutions (see, *infra*).

Along with unanimity, the current proposal envisages three different voting majorities of the two governing bodies, whose validity is subject to a 2/3 quorum of present and voting EMF MSs: a reinforced qualified majority equal to 85% of the votes cast; a qualified majority amounting to 80% of the votes cast; a simple majority of the votes cast. The matrix below explains the interaction among voting majorities of the Board of Governors and the cases under which the Council shall approve key Fund decisions.

Decision to (Art)	Majority	Council decision
increase or provisionally decrease minimum lending capacity (8(6))	Unanimity	Yes
make capital calls (9(1))	Unanimity	Yes

increase the authorised capital stock (10)	Unanimity	Yes
take into account possible updates to the key for the subscription of the ECB's capital and the changes to be made to the contribution key in use for the EMF (11(4) and (5))	Unanimity	Yes
approve changes to be made to the distribution of capital among EMF Members and the calculation of such a distribution as a direct consequence of a MS becoming a new EMF MS (11(3))	Unanimity	No
adopt the terms and conditions of the EMF support to the SRB (22(4) and 23(1))	Unanimity	Yes
confirm or revise the terms and conditions of a support scheme to the SRB (22(5))	Unanimity	Yes
grant stability support to EMF Members in the form of a financial assistance facility (13(2) and (3), request and approve the MoU negotiated among the concerned MS, the EC and the ECB (13(4))	Reinforced qualified majority	Yes
establish the choice of instruments and the financial terms and conditions (14-18)	Reinforced qualified majority	Yes
adopt and review the pricing guideline for granting stability support, providing credit lines or setting guarantees (20)	Reinforced qualified majority	No
set out the detailed technical terms when a MS becomes an EMF Member	Qualified majority	No
elect its Vice-Chairperson	Qualified majority	No
determine the list of activities incompatible with the duties of a Director or an alternate Director	Qualified majority	No
adopt the shortlist of candidates for the position of the Managing Director and request the Court of Justice for the removal of the latter	Qualified majority	No
set out the rules of procedure of the Fund	Qualified majority	No
establish other funds (27)	Qualified majority	No
decide on the actions to be taken for recovering a debt from an EMF Member (28(2) and (3))	Qualified majority	No
approve the annual accounts and annual report of the EMF (31 and 32)	Qualified majority	No
approve the external auditors (34)	Qualified majority	No
appoint the members of the Board of Auditors (35(1))	Qualified majority	No
decide on the working language of the EMF (47)	Qualified majority	No
adopt detailed guidelines on the procedure for implementing the instrument for the direct recapitalisation of credit institutions (19(4))	Simple majority (?)[37]	Yes

As clearly shown by the table above, the Council plays a crucial role for the definitive adoption of several decisions already endorsed by the Board of Gover-

[37]The Statute does not specify the majority for taking such a decision, being the sole case in which the Board of Governors shall adopt detailed guidelines.

nors. Indeed, all decisions concerning the disbursement of funds and the setting up of guarantees must be approved by the Council and published in the European Official Journal. Decisions by the Council shall always provide reason: as a consequence of the Council's lead, any new decision by the Board of Governors on a subject matter upon which the Council provided its objection shall respect the reasons given by the Council itself, thus potentially giving ground for an action for annulment.

In addition to the above, the Council shall also approve certain decisions taken by the Board of Directors pursuant to Article 9(2) (call in authorised unpaid capital), Article 14(4) (adopt detailed guidelines on the modalities for implementing EMF precautionary assistance), Article 15(4) (adopt detailed guidelines on the modalities for implementing financial assistance for the re-capitalisation of an EMF Member's credit institutions), Article 19(5) (approve the recapitalisation of credit institutions resorting to EMF support), Article 16(4) (adopt detailed guidelines on the modalities for implementing EMF loans), Article 17(4) (adopt detailed guidelines on the procedure for implementing the primary market support facility), Article 18(5) (adopt detailed guidelines on the procedure for implementing the secondary market support facility), and Article 23(3) (adopt detailed guidelines on the modalities for implementing EMF credit lines or guarantees to the SRB) of the EMF Statute. The Council will hence have a final say in the definition of the "rules of the game" which will govern the Fund's relations with its participating MSs, hence reducing to a very narrow space the autonomy of the governing bodies of the Fund.

Against this general background, the EMF Regulation introduces also an emergency procedure which shall be activated to accelerate Council's endorsement in all the cases enlisted under current Article 3(2). Indeed, when circumstances require the urgent provision of stability support to an EMF Member, decisions approved by the Board of Governors shall be immediately transmitted to the Council, which shall discuss them within 24 hours. In case of objection, the Council may either adopt a decision itself on the matter or refer it back to the Board of

Governors for another decision to be taken. Notably, the urgent procedure can be also used to adopt, confirm or revise the terms and conditions of an EMF support operation to the SRB according to article 22 of the EMF Statute. Alike decisions approved through the ordinary procedure, urgent decisions by the Council, including objections to decisions by the Board of Governors, shall be duly motivated.

The increased role of the Council raises an important issue with regard to the asymmetries in EU economic governance decision-making. In particular, both the decisions to support Eurozone MSs and to provide sustain to the SRB will be undertaken by the Council as a whole, thus involving the participation of non-Eurozone countries. This is particularly worrisome with respect to the provision of SRB support, where the decisions by the Board of Governors are rather taken in agreement with the MSs participating in the SSM.

Finally, an interesting feature of the proposed institutional architecture of the EMF is represented by the accountability mechanisms envisaged by the founding Regulation. The proposal of the EC essentially builds upon the regime put in place for the ECB with regard to the discharging of its responsibility within the SSM. In this regard, one can note that there are two “streams” of interaction that the EMF Regulation seeks to create.

On the one hand, mechanisms to ensure a continuous dialogue towards the European Parliament and the Council are established: these include the transmission of an annual report along with the annual accounts and financial statement, complemented by a general debate with the Managing Director on their content, hearings, oral or written reply to questions submitted by the European Parliament and the Council, and «confident oral discussions behind closed doors»[38] with the Chair and Vice-Chairs of the competent committees of the European Parliament.

On the other hand, the accountability regime stresses the role of national parliaments. Reports on its activities addressed to the European Parliament, the Council and the EC shall be simultaneously forwarded to the national Parliaments

---

[38] See Article 5 of the proposed Regulation.

of the EMF MSs and of any non-Euro SSM MS. The latter could address their reasoned observations on that report to the EMF, request the Fund to reply in writing to any relevant remarks or questions, and invite the Managing Director to «an exchange of views in relation to the progress made regarding the implementation of the financial stability support»[39].

In this respect, the main concern stems from a broader consideration of the puzzling accountability framework which growingly emerges in the economic governance of the Eurozone. Rather than a streamlined and rationalized system, the formal accountability regime appears a patchwork of different and potentially inconsistent mechanisms centered on a plurality of actors. In the absence of a single and unitary reference due to a fragmentation of methods and actors, a risk of accountability overload on the side of the European and national Parliaments (*i.e.*, the addressees of accountability duties) might concretely frustrate the effectiveness of the regime and reduce their contribution to the legitimation of EU economic governance.

3. It is three years now since the EC published the text of a proposal still under discussion for a Regulation[40] and a communication[41] on the establishment of the EDIS. These documents were submitted as a starting point for negotiations on a broader package of measures aimed at deepening the EMU on the basis of the five Presidents' report[42]. Indeed, aside from the EDIS, the plan envisaged by the EC included *i)* a move to a unified representation for the Euro area in the IMF by the President of the Euro Group, *ii)* a project to streamline and rationalize the European semester as the core of budgetary control on MSs, as well as *iii)* the im-

[39]See Article 6(3) of the EMF Regulation.
[40]See Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM (2015) 586 final.
[41]See Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions "Towards the completion of the Banking Union", COM (2015) 587 final.
[42]See above, § 2.

provement of the tools of economic governance through the establishment of the National Competitiveness Boards and the European Fiscal Board.

At present, the major stall on the process towards the final agreement on the EDIS is notoriously represented by the fear of cross-subsidization by "creditors countries'" towards "debtor countries'" banking systems, along with a more general distrust in a mechanism which could potentially heighten private moral hazard and decrease market discipline via reduced depositors' monitoring of banks' reliability. Put it simply, the risk that the banking sector in one MS would have to pay for bank failures in another MS is perceived as politically (and economically) unacceptable[43], also in light of the limited degree of cross-border integration of the retail financial system, which a depositor scheme mainly protects.

By giving political voice to these concerns, in June 2016 the Economic and Financial Affairs Council (Ecofin) concluded that political negotiations on EDIS would start as soon as «sufficient further progress has been made on the measures on risk reduction», while it took note of the intention of MSs to resort to an intergovernmental agreement to ensure its setting-up[44]: a reference to the ongoing issue of NPLs in banks' balance sheets as a legacy of the unprecedented global financial crisis was clearly regarded as the core issue to be satisfactorily addressed by a number of MSs, including Italy, before taking further steps forward. On it turn, the EC attempted to formalize a new approach to the EDIS, which would imply a more gradual entry into force of a fully-fledged scheme (see, *infra*, § 3.2).

In order to introduce an overview of the features and challenges of the proposed EDIS, the next subparagraph discusses the rationale for the establishment of deposit insurance schemes as part of the safety net of the banking and financial system; a brief overview of the regulatory evolution of these mechanisms

[43]See CARMASSI, DOBKOWITZ, EVRARD, PARISI, SILVA, WEDOW, *Completing the Banking Union with a European Deposit Insurance Scheme: who is afraid of cross-subsidisation?*, ECB Occasional Paper Series, No. 208, April 2018.
[44]See www.consilium.europa.eu/en/press/press-releases/2016/06/17/conclusions-on-banking-union/.

within the EU Single Market will also be provided, so as to put the EDIS in the broader context of regulatory policy changes occurred in the aftermath of the global financial crisis.

3.1 As already remarked above (see, *supra* § 2.1), deposit insurance schemes are a key part of the safety nets which assist banking and financial systems worldwide. These are indeed viewed as «a supplement to other official measures which are designed to protect bank depositors from the risk of loss or to contain that risk»[45]. In this respect, the existing literature provides several arguments for supporting the establishment of deposit guarantee schemes, although multiple views on their possible arrangements and incentives to reduce embedded risks of moral hazard have been advanced to date.

According to the classic work of MacDonald[46], the direct rationale for deposit insurance is consumer protection, provided that social and political pressures seek to ensure that depositors - and especially most vulnerable ones - are protected from losses when interacting with credit institutions. A second typical argument to justify deposit insurance schemes is that depositors are ill-equipped to assess the financial conditions and reliability of the bank they put their money in, mainly due to the existence of information asymmetries and the lack of consumers' ability to eventually process in a rational and accurate manner such evidence. Thirdly, as part of the safety net, these schemes indirectly reduce the likelihood of systemic banking crises, as long as they act as a disincentive to bank runs and prevent contagion and panic to spread over the system: in this regard, the more extensive is the public knowledge about their existence and functioning, the less likely is the risk of a bank run based on irrational fears by depositors; in turn, this will enhance their effectiveness and prevent harmful halts to the payment system and credit flow to the economy.

[45]See MACDONALD, *Deposit Insurance*, in Handbooks in Central Banking, no. 9.
[46]*Ibid*, 8.

An additional argument for setting up deposit guarantee schemes is that these can swiftly contribute to provide direct bridge financing in case of small scale banking crises: indeed, in case of impending bank(s) failures deposit schemes dispose of readily available resources which can be (more efficiently) used *before* a depositors' payout is triggered, thus acting as a preventive mechanism with a self-incentive to avoid more expensive reimbursements[47]. In the EU, this additional argument is clearly expressed in the sixteenth whereas of Directive 2014/49/EU (see *infra*), where it is recognized that it should be possible for deposit guarantee schemes «to go beyond a pure reimbursement function and to use the available financial means in order to prevent the failure of a credit institution with a view to avoiding the costs of reimbursing depositors and other adverse impacts», notwithstanding full compliance with the rules on State aids.

Despite these broadly accepted rationales, the effective arrangements for deposit insurance schemes vary significantly across the world, showing a substantial variety of domestic solutions based on several key criteria.

Scholars draw a basic preliminary distinction between implicit and explicit guarantees. Quite intuitively, while the first type of schemes is not laid down by law or regulation and is implicitly deduced from political unwillingness to leave vulnerable depositors to their own devices in case of crisis[48], the second group entails a statutory or private protection scheme with predefined conditions for funding, rules of intervention, maximum coverage and governance features. Among the latter group, further sub-distinctions can be drawn among mechanisms with *i)* pre-funded vs. on-call (*i.e., ex post*) financing, *ii)* capped vs. uncapped reimburse-

---

[47]See also TARANTOLA, *Strengthening financial stability – the contribution of deposit* insurance, Conference on financial stability and the contribution of deposit insurance, Rome, 30 September 2010, who remarked that «Deposit Guarantee Schemes should be able to absorb the impact of medium magnitude crises or, where possible, to promptly intervene to avoid bank failures in the interest of depositors. The more effective a DGS, the greater will be depositor confidence, reducing the risk of bank runs and limiting contagion from banks in distress» (5).

[48]As put by DEMIRGÜÇ-KUNT et al., «(i)mplicit insurance exists to the extent political incentives that influence a government's reaction to large or widespread banking problems make taxpayer bailouts of insolvent banks seem inevitable»; see DEMIRGÜÇ-KUNT, KANE, LAEVEN, *Deposit Insurance and Implementation: Policy Lessons from Research and Practice*, in Ids. (eds.), *Deposit Insurance Around the World: Issues of Design and Implementation*, Cambridge, MIT Press, 2008.

ments, *iii)* private (sectoral or systemic) vs. public (or even mixed) financing, *iv)* public authorities' control vs. private governance, *v)* legal personality vs. lack of autonomous legal capacity, and *vi)* voluntary vs. mandatory adherence[49].

Within the EU Single Market, the regulation of deposit guarantee schemes made significant progresses only in the aftermath of the global financial crisis. Before the enactment of Directive 2009/14 and Directive 2014/49, only few references to guarantee schemes could be identified in preliminary studies surrounding the enactment of the First Banking Directive and the lately finalized 2001 directive on the winding-up of credit institutions[50].

The introduction of a fully-fledged banking regulatory system by the Second Banking Directive in the '80s, encompassing harmonized rules, mutual recognition and home country control towards cross-border active banking players resorting to freedom of establishment or freedom to provide services, created the proper conditions for enacting common European rules on deposit guarantee schemes. On this basis, Directive 94/19[51] introduced a regime under which MSs were mandated to establish a guarantee scheme whose adherence to had to be made compulsory for all authorized credit institutions. Coverage level was set at 20.000 ECU per deposit with limited flexibility clauses, while "home schemes" were called to cover deposits arising from passported activities with a view to eliminate restrictions to cross-border business and foster EU market integration.

Following a substantial period of stability of the EU regulatory environment in this area, an overturn occurred as a consequence of the global financial crisis. The limits of the EU deposit insurance regulation were fully exposed by the Icelandic banking crisis, which proved the defective features of a mechanism based

---

[49]For an account of the globally accepted governing principles for deposit insurance schemes, see Basel Committee on Banking Supervision, *Core Principles for Effective Deposit Insurance Systems*, 2009. A further classic analysis of deposit guarantee schemes' features is provided by G. Garcia, *Deposit Insurance and Crisis Management*, IMF Working Paper, WP/00/57, 2000, 4-6.

[50]See Directive 2001/24/EC of the European Parliament and the Council of 4 April 2001 on the reorganization and winding up of credit institutions.

[51]See Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit guarantee schemes.

on minimum harmonization and home coverage of cross-border deposits[52]. As a consequence, the European legislators agreed to move towards an increase of mandatory amount coverage and the transformation of the existing regime.

At first, Directive 2009/14/EC[53] strengthened the minimum requirements for deposits coverage in MSs with the declared objective to maintain depositor confidence and attain greater stability on the financial markets. In this respect, the amendments to the ’94 Directive led to an increase of the minimum coverage level to 50.000 euros, with a foreseen further increase at 100.000 euros by the end of 2010, subject to an assessment by the EC. In addition, a reduction of the payout delay to a maximum period of 20 working days was introduced: this could be extended only under exceptional circumstances and after approval by the competent authorities.

Following a 2010 proposal by the EC to amend the ’94 Directive so as to overcome the minimum harmonization approach and definitively set a uniform coverage amount to 100.000 euros, Directive 2014/49[54] was later enacted. The Directive currently in force focuses not only on the achievement and strengthening of the internal market – as seen, a clear goal of common deposit insurance rules since the earliest regulatory intervention – but also on the objective of increasing the stability of the banking system and the protection of depositors, especially in light of «the costs of the failure of a credit institution to the economy as a whole and its adverse impact on financial stability and the confidence of depositors»[55]. By extensively updating the previous regime, the new Directive introduced a mechanism under which private contributions to DGSs are based on the amount of covered deposits and the degree of risk incurred by the respective member, so as to reflect the risk profiles of participating individual institutions and reduce

[52]For a detailed account, see MESSINEO, *Sistema di garanzia dei depositi nell'Unione europea*, in Enc. del diritto, Milano, Giuffré, 2016, 960.
[53]See Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay.
[54]See Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.
[55]See Whereas (3) of Directive 2014/49.

moral hazard. Further rules on the financing and minimum target capacity of deposit guarantee schemes, calculation of contributions by credit institutions and the setting up of borrowing arrangements between MSs' funds were introduced to increase the degree of harmonization and cooperation among "European insurers".

The important developments within the Single Market briefly summarized herein were not paralleled by a rationalization and centralization of the regime following the establishment of the EBU. As recently noted by Carmassi et al., the creation of a common deposit insurance for centrally supervised credit institutions should rather be a logical step towards the accomplishment of the EBU: indeed, «(e)nsuring a uniform protection of depositors across the entire banking union, regardless of geographic location, is a crucial element to preserve depositors' trust and thus avoid bank runs and protect financial stability»[56]; its ultimate goal is to strenghten and preserve the value of the single currency, the basic trait-d'union between the EBU and the EMU. The regime currently in place is hence inconsistent with the growingly supranational dimension of the safety net, and it does not allow for an effective breaking up of the dooming nexus between sovereign and banks; in addition, it maintains important coordination costs since the entry into force of the SRM, provided that the functioning of the latter would potentially have to deal with the legal underpinnings and features of 19 different regimes.

3.2 The proposal delivered by the EC for the structural completion of the EBU seeks to establish a common deposit protection for the whole Eurozone area in a progressive manner. As anticipated above, the EDIS Regulation would amend the current SRM Regulation by establishing a Deposit Insurance Fund (DIF) to be managed by the SRB. The Fund would not immediately reach full capacity: the process is conceived as shifting from a basic reinsurance scheme to a progressive full coverage to be reached at least seven years after the effective launch of the

[56]See CARMASSI, DOBKOWITZ, EVRARD, PARISI, SILVA, WEDOW, *Completing the Banking Union*, cit., 12.

project, hence covering three stages of *i)* reinsurance, *ii)* co-insurance and *iii)* full insurance.

In detail, during the first stage coverage would be limited to resolution proceedings conducted by the SRB, thus leaving national resolution procedures fully out of scope. The basic condition for the activation of the scheme would be the existence of a liquidity shortfall of a participating deposit guarantee scheme (DGS), to be ascertained according to two different processes depending on whether the DGS *i)* encounters a payout event, or *ii)* has to contribute to resolution. In the first case, the shortfall occurs when the amount of covered deposits in the failing bank is larger than the total of both the value of the financial means the DGS should hypothetically have and the amount of extraordinary ex post contributions the DGS can raise within three days from the payout; in the second case, the shortfall occurs solely when the first bucket of such resources are not enough to cover the planned contribution to the resolution, thus excluding the extraordinary ex-post levy. The total (capped) funding the EDIS would be entitled to provide is equal to 20% of the liquidity shortfall, *i.e.*, a fairly small fraction of the total amount to be called in to cover deposits or sustain resolution.

During this first stage, the EDIS would also cover the 20% of the participating DGS's *excess loss*, a concept which once again differs depending on whether the DGS incurs a payout event or should contribute to a resolution. In a nutshell, the difference among the two is represented by the fact that in case of a resolution the DGS shall not mandatorily raise ex-post contributions to resort to the EDIS, as the excess loss is herein understood as the amount the participating DGS should contribute to resolution less the sum of *i)* the amount it may have been reimbursed after a subsequent valuation found out that its contribution should have been lower than initially requested by the resolution authority, and *ii)* the amount of available financial means that the participating DGS should have in place[57].

---

[57]This explanation draws upon the description provided in the Proposal for the EDIS Regulation; see at 10 ff.

During the second stage, which is planned to last four years, DGS may request both funding and loss cover within the meaning discussed above in case of payout events or contributions to resolution, the latter including also purely national ones. In this phase, the EDIS will step in since the very beginning, as it will provide an increasingly larger share of participating DGSs' liquidity needs, starting from 20% up to 80% of the total. This mechanism would continue in the final stage, where the EDIS will provide 100% insurance to participating DGSs, thus ensuring full funding of the liquidity need and coverage of all losses stemming from a payout event or a contribution to resolution.

A number of arrangements seek to reduce the likelihood of moral hazard, which is *per se* one of the major concerns of deposit insurance approaches. First of all, the contributions to the common deposit insurance will be calculated on the basis of banks' riskiness: during the co-insurance stage, such calculation will be referred to the national banking system, *i.e.*, linked to the riskiness of banks in the same country; in the later phases, it will turn truly European, as it will consider as a reference the degree of riskiness of all banks in the Banking union[58]. Secondly, Article 41j of the proposed EDIS Regulation puts a strict condition on access to the common deposit guarantee facility: indeed, it is established that participating DGSs can be re-insured, co-insured or fully insured only if they respect certain yearly target of funding calculated as a percentage of the total amount of covered deposits of the affiliated credit institutions[59].

In its communication on the completion of the Banking Union of October 2017, the EC notably proposed a new approach to EDIS, which seeks to address some of the concerns expressed by EU institutions and national governments on the envisaged three stages. In particular, the EC agreed to take a more gradual stance in the introduction of the EDIS, mainly through the following main changes:

[58]See CARMASSI, DOBKOWITZ, EVRARD, PARISI, SILVA, WEDOW, *Completing the Banking Union*, cit., 11-12.

[59]Upon consultation with the SRB, the EC may approve a temporary and conditional derogation from such yearly requirements for duly justified reasons linked to the business cycle in the respective MS, the potential impact of pro-cyclical contributions or a payout event occurred at national level. See Article 41j(2) of the EDIS Regulation.

first, the EC proposed that the EDIS should not provide coverage of losses during the re-insurance stage, while ensuring a higher protection for liquidity shortfalls in a payout event, peaking to 90% in the third year; secondly, the transition to the second phase would be made conditional to the fulfillment of a number of conditions to be assessed by the EC itself, including the reduction of NPLs and Level 3 assets, which could eventually signal a general lowering of risk in the EBU.

Notwithstanding the recent suggested amendments and the technical aspects discussed in short above, an interesting aspect of the original proposal of the EC is the impact its implementation would have on the role of the SRB in the institutional architecture of the EBU and of the EMU as a whole. The entry into force of the EDIS would indeed significantly expand the importance (and tasks) of the SRB, whose features would be closer to those of the US Federal Deposit Insurance Corporation (FDIC), albeit with the lack of any supervisory power whatsoever.

First of all, the Board would be renamed as *Single Resolution and Deposit Insurance Board* following its new task to manage the deposit insurance fund along with participating deposit guarantee schemes or national designated authorities responsible to administer the respective participating deposit guarantee scheme[60]. To this end, the project seems in line with the suggestions expressed by Gros and Schoenmaker, who contended the establishment of a *European Deposit Insurance and Resolution Authority* «to stabilize the retail deposit base and resolve troubled cross-border banks», *i.e.*, an agency independent from the ECB and the European Banking Authority (EBA) and managing a fund «fed through regular risk-based deposit insurance premiums with a fiscal backstop of the European Stability Mechanism»[61].

In this regard, one could note that also in discharging its tasks under the EDIS, the SRB would be called to respect the general principles set out in Article 6

---

[60]See EDIS Proposal, at 4.
[61]See SCHOENMAKER, GROS, *A European Deposit Insurance and Resolution Fund*, cit., passim.

of the SRM Regulation, including the obligation *i)* to prevent any discrimination towards any entity, deposit holder, investor or other creditor established in the EU on grounds of their nationality or place of business, and *ii)* to undertake every action, proposal or policy with full regard and duty of care for the unity and integrity of the internal market, along with the new duty to not take any decision that require MSs to provide extraordinary public financial support or that impinge on their budgetary sovereignty and fiscal responsibilities. The managing role entrusted to the SRB implies also that the latter will have an oversight role to ensure full discipline of participating DGS: indeed, the Board will be entitled to disqualify a participating DGS when it fails to observe its target funding obligations under the EDIS.

Secondly, the administration of the EDIS will give rise to interesting procedural mechanisms which will involve DGSs, national authorities and the Commission; these which will also overlap with the resolution procedure currently laid down in the SRM Regulation in force, while changing a number of features of the current SRB governance. Under a procedural perspective, it is mainly possible to distinguish between two different administrative procedures with a vertical dimension, which will add to the already composite framework established for recovery and resolution. The first procedure is the one to be followed in order to activate funding, under which the participating deposit guarantee schemes will be mandated to alert the SRB without undue delay once they «become aware of circumstances that are likely to result in a payout event or a request from the resolution authority to contribute to resolution» (Article 41i).

The second procedure will regard ex-post monitoring of the use of provided funding and the efforts of participating deposit guarantee schemes to collect deposit claims from insolvency proceedings. In this regard, the EDIS Regulation establishes that the participating deposit guarantee scheme shall repay the funding provided by the SRB, less the amount of any excess loss cover when deemed applicable. The SRB will hence monitor recovery by the concerned participating deposit scheme up until termination of the insolvency procedure or resolution procedure where the final loss will be determined. Quire remarkably, in relation to the SRB monitoring of insolvency procedures, it is established that a participating deposit guarantee scheme shall maximize its proceeds from the insolvency estate and shall be liable towards the SRB for any amounts not recovered due to a lack of diligence; after a hearing of the participating deposit guarantee scheme, the SRB may also take a decision to exercise itself all rights arising under the deposit claims, thus substituting to the concerned scheme.

4. Since the breaking up of the global financial crisis, the EU has undertaken an ambitious path towards a comprehensive reform of its administrative architecture of financial regulation and supervision. Nonetheless, despite the devoted efforts, the completion of a fully-fledged safety net for the banking and financial sector in the Eurozone aimed at reinforcing the preconditions for financial stability is still far from being achieved. Aside from the apparently technical constraints which obstacle any agreement on the two projects discussed in previous paragraphs, two key divides should be considered in the road ahead towards a more stable European economic integration, pointing to the problem of the double constitutional model emerged from Lisbon[62].

The first element is institutional. The proposals submitted on both the EMF and the EDIS seek to pursue ambitious goals of risk sharing and prevention of widespread instability in the Eurozone; at the same time, these further complicate the fragmented institutional landscape of the European economic governance and reconfirm the tendency towards intergovernmentalism in crisis management[63], whose logic still falls short from being critically discussed. Indeed, the specific features of the EMF are clear in showing the perpetuation of a model under which

[62]See FABBRINI, *La crisi dell'euro e le sue conseguenze*, cit., 657.
[63]This point has been remarked by several prominent scholars. See, *inter alia*, ROSSI, *"Fiscal Compact" e Trattato sul Meccanismo di Stabilità: aspetti istituzionali e conseguenze dell'integrazione differenziata nell'UE*, in Dir. Un. Eur., 2012, 293; CHITI, *L'*accountability *delle reti di autorità amministrative dell'Unione europea*, in Riv. it. dir. pubbl. comunit., 2012, 29; ANTONIAZZI, *L'Unione bancaria europea: i nuovi compiti della Bce di vigilanza prudenziale degli enti creditizi e il meccanismo unico di risoluzione delle crisi bancarie*, in Riv. it. dir. pubbl. comunit., 2014, 717.

«the national governments assembled in the Eurogroup of the European Council have extended their scope for action at the cost of their national parliaments and as a result have greatly exacerbated the existing shortfall in legitimacy»[64] of the EU as a whole: the movement towards a truly supranational integration is hence only partial, reinstating the will of national governments to have a final say in policy actions aimed at securing financial stability.

The asymmetries affecting the current design could be addressed only through important amendments to Treaties which might prove even harder to accomplish. In order to reach a compromise between national control and democratic legitimacy, a stronger governing role as well as political and legal accountability of the Eurogroup should be ensured, provided that the latter's formal legal status substantially departs from its actual importance in the equilibria of the governance of the EMU[65]; this should be paralleled by an even stronger oversight by the European Parliament, which is ultimately unable to effectively keep economic governance players accountable due to the lack of autonomous legislative powers. Secondly, the technical capacity and political legitimation of a reinforced Eurogroup should be combined with the completion of the project towards the establishment of a European Minister for the Economy and Finance, to be put under EU parliamentary control. Thirdly, a redefinition of the role of European agencies in the financial sector should be addressed, given that the (effective or perceived) legal constraints actually impede to fully exploit the advantages of delegating decision-making beyond the intricacies of EU institutions.

These aspects point to the second important element, which is the ongoing search for an equilibrium between technique and politics. In the current landscape, these both can be descripted as trapped in a classical "Mexican standoff", where all parties involved impede each other to take any action. A trend towards increased relevance of "technocratic solutions" has clearly emerged as a reaction to the emergencies brought on the table by the financial crisis, as shown by the

[64]See HABERMAS, *Democracy in Europe*, cit. 551.
[65]See CRAIG, *The Eurogroup, power and accountability*, in European Law Journal, 2017, 234.

expanded role of the ECB in key nodes of the safety net, the establishment of financial agencies with extensive regulatory responsibilities under the aegis of the EC, and the setting-up of a first line of defense in the financing of resolution actions through the SRF[66]. Nonetheless, politics has not disappeared, maintaining a strong control on the breadth and effectiveness of the Eurozone safety net through a range of actions and inactions: these imply that the center of the scene is still dominated by issues of "domestic short-term return" rather than EU financial stability, which might move back and forth the equilibria in the institutional system.

In this regard, one could only note that any further step in the agenda towards a more integrated Eurozone will reasonably be taken when MSs will accept that the definitive breaking of the vicious circle among sovereigns and banks will occur only when another dooming loop will be interrupted: the one between political short-termism and the permanent uncertainty in attaining the long term value of enduring and common financial stability. In the end, the completion of both the EMU and the EBU awaits the much needed setting-up of a democratic fully-fledged political Union.

[66]As noted by Capriglione and Sacco Ginevri, «(t)he limits of the EU governance [...] explain the reason why, at the beginning of the financial crisis of 2007, the definition of policy mechanisms able to correct (or at least contain) the damages (arising from the same) was searched mainly in the technique»; see. CAPRIGLIONE, SACCO GINEVRI, *Politics and finance*, cit., 19.

DEFINING A EU-FRAMEWORK FOR FINANCIAL TECHNOLOGY (FINTECH): ECONOMIC PERSPECTIVES AND REGULATORY CHALLENGES *

Cemal Karakas ** - Carla Stamegna ***

'Banking is necessary, banks are not'[1]

ABSTRACT: *The term Financial Technology (FinTech) refers to firms that use technology-based systems either to provide financial services and products directly, or to make them more efficient. Examples include internet banking, mobile payments, crowdfunding, robo-advice and virtual currencies. These applications show that the digital revolution is irreversibly changing the way people live, including the way they interact with the financial system. The rapidly growing FinTech sector has its rewards and challenges (e.g. data and consumer protection issues, risk of exacerbating financial volatility and cybercrime) and has been increasingly attracting political attention at the supranational level. Thus, the fundamental question of this paper is: how is the European Union dealing with FinTech? Due to the broad scope of FinTech, EU regulators face a dilemma: on the one hand, rule-based regulatory frameworks set out compliance obligations clearly, but these are often expensive from a start-up perspective and could be an obstacle to innovation and job creation. On the other hand, principle-based regulation is more flexible, but could create some uncertainty as to what exactly is expected in terms of compliance. A possible middle ground could be found by evolving towards a more dialectic supervisory model.*

---

*This publication is the modified and updated version of the authors' European Parliamentary Research Service (EPRS) Briefing 'Financial technology (FinTech): Prospects and challenges for the EU', published in March 2017.
The views and opinions expressed herein belong only to the Authors and neither involve nor represent the positions of any affiliated institution.

**Policy Analyst at European Parliamentary Research Service (EPRS).
***Policy Analyst at European Parliamentary Research Service (EPRS).

[1]Bill Gates, principal founder of Microsoft, in early 1994.

SUMMARY: 1. Introduction. – 2. Evolution and economic prospects of FinTech. – 3. FinTech related current EU regulation. – 4. Big Data and consumer protection. – 5. Cybercrime and Cybersecurity. – 6. Virtual currencies and blockchain. – 7. FinTech law-making: ideas and challenges for regulators. – 8. FinTech: Where does the EU stand?

1. In recent years, the expression FinTech, the abbreviation for financial technology, has become a synonym for the emerging financial services sector in the 21st century. In this context, FinTech covers a broad range of services and products, such as cashless payments, peer-to-peer (P2P) lending platforms,[2] robotic trading, robo-advice,[3] crowdfunding platforms,[4] and virtual currencies,[5] and is expected to expand further in the coming years.

Originally, FinTech referred to technology applied to the back-end of established consumer and trade financial institutions. Today, the interpretation of FinTech has expanded to cover any technological innovation in the financial sector, including innovations in financial literacy and education, retail banking, investment or office improvement (e.g. back-office functions). The dynamic and rapidly growing FinTech sector is increasingly attracting interest at the political level. In Europe, on the one hand attention is paid to the potential contribution that FinTech might make to increase efficiency, strengthen financial integration and enhance the European Union's role as a global player in financial services; on the other hand, the need is pressing for clear, safe and effective regulation supporting innovation while also

[2]Peer-to-peer (P2P) lending is a method of debt financing without the use of an official financial institution as an intermediary. It is also described as 'social lending'.

[3]Robo-advice is replacing face-to-face investment advice with online, automated guidance and execution which relies on algorithms. Potentially, robo-advice could deliver financial advice in a more cost-efficient way, making it affordable for a wider range of investors.

[4]Crowdfunding, the use of capital from several individuals (via social media and specialised websites) to finance a business project, allows start-ups to raise money without giving up control to venture capital investors. Yet, critics argue that funds may, for instance, be used for different purposes than those initially disclosed, or that tax laws governing e-commerce are not clearly defined, e.g. in the case of cross-border funding.

[5]Virtual currencies are digital representations of value, issued by private developers and denominated in their own unit of account which can be obtained, stored, accessed, and transacted electronically. The concept of virtual currencies covers a wider array, including internet coupons, airline miles, and cryptocurrencies such as Bitcoin.

protecting consumers. Indeed, although more and more regulation in the field of financial services is defined at a European or international level, areas remain where Member States can choose to apply individualised or less strict rules at national level (e.g. peer-to-peer lending and virtual currencies). This can result in either a fragmented environment preventing businesses from expanding across borders, or an uneven playing field and arbitrage opportunities, incentivising companies to obtain permits in less restrictive jurisdictions in order to minimise regulatory burdens while operating internationally. It should also be noted that, generally speaking, FinTech business models may not fit within the licensing regulations and ordinary supervisory procedures, designed for the 'classical' type of financial institutions (e.g. banks).

2. The interlinking of finance and technology is not a new phenomenon, beginning as far back as the 1860s, when the laying of the first transatlantic cable for telegraph communications launched the first age of financial globalisation by allowing the rapid transmission of financial information, transactions and payments around the world. Technological progress, such as the telex machine, the introduction of credit cards, handheld financial calculators and automatic teller machines (ATMs) in the 1950s and 60s, as well as the switch from analogue to digital industry in the 1970s, increased the speed of financial globalisation. The broad accessibility of the internet, the introduction of mobile phones, online banking and program trading in the 1980s, were further important financial innovations.[6]

In addition to these innovations, the global financial crisis of 2008-2009 contributed to set the framework for financial services and information technology as we know it today, and had a catalysing effect on FinTech. Indeed, the post-crisis financing gap, the growing public distrust of formal financial institutions and

---

[6]See ARNER, BARBERIS, BUCKLEY, The Evolution of FinTech: A New Post-Crisis Paradigm?, University of Hong Kong Faculty of Law Research Paper No 2015/047, UNSW Law Research Paper No. 2016-62, 2015 (Last revised 7 Sep 2016).

regulatory reforms such as the Dodd Frank Act or Basel III have increased financial institutions' compliance obligations (e.g. higher capital and reporting requirements) and introduced economic viability ('stress') tests, but they also paved the way to the rapid growth of the FinTech sector, by increasing the opportunities for FinTech firms to enter the financial sector providing innovative and cheaper services directly, or making traditional business more efficient.

FinTech today comprises five major areas, for which Arner *et al.* suggest the following topology:[7]

(1) Finance and investment such as alternative financing mechanisms, particularly crowdfunding and P2P lending, but also robo-advisory services;

(2) Operations and risk management to build up better compliance systems (i.e. RegTech);[8]

(3) Payments and infrastructure, such as internet and mobile payment systems, and infrastructure for securities trading and settlement and for over-the-counter (OTC) derivatives trading;

(4) Data security and monetisation to enhance the efficiency and availability of financial services (through the use of 'big data'), to better exploit the monetary value of data, and to tackle cybercrime and espionage;

(5) Customer interface such as online and mobile financial services.

According to a 2018 report, the total global investment in the sector since 2010 reached almost US$100 billion.[9] In 2017 alone, FinTech financing rose 18 percent and set a new record. The amount of FinTech venture capital investment in 2017 saw around 2,700 deals globally, attracting US$ 27.4 billion of venture capital

---

[7]See ARNER *et al.* 2015, *op. cit*., pp. 18-20.

[8]RegTech stands for 'regulatory technology'. It consists of a subset of FinTech firms providing technological solutions to help financial institutions to comply with regulatory requirements efficiently and inexpensively. Based on data-processing, RegTech allows companies to integrate the fulfilment of compliance requirements into business processes, improving companies' governance and management. Furthermore, by offering scalable solutions, it lowers entry barriers and costs for market participants.

[9]See Accenture, News release 'Global Venture Capital Investment in Fintech Industry Set Record in 2017, Driven by Surge in India, US and UK, Accenture Analysis Finds, 28 February 2018.

investment - compared to some 1,800 global deals and US$ 23.3 billion of venture capital investment in 2016. While the value of deals in the US jumped 31 percent to US$ 11.3 billion, deal values almost quadrupled in the UK to US$ 3.4 billion, and soared nearly fivefold in India to US$ 2.4 billion. FinTech funding in China, on the other hand, declined 72 percent in 2017 to US$ 2.8 billion - from a record US$ 10 billion in 2016.[10]

In Europe, according to another 2018 report, the overall FinTech funding for 2017 was US$ 7.44 billion across 446 deals.[11] Among FinTech sub-sectors, both insurtech[12] and blockchain[13] saw record levels of venture capital investment and deal volume in 2017, with insurtech accounting for US$ 2.1 billion across 247 deals and blockchain generating $ 512 million of investment across 92 deals.[14]

In recent years, an increasing number of start-ups raised capital in lieu of equity directly on peer-to-peer (P2P) lending platforms. While P2P in the UK now represents about 14 percent of new lending to small businesses.[15] In the US, due to the Jump Start Our Business (JOBs) Act of 2012, the number of P2P operators has risen from 10 in 2010 to 111 in 2015, an annual increase of 61.8 percent. Further potential growth channels include student loans and the securitisation of P2P loans. In 2020, industry revenue is supposed to grow 19.2 % annually to US$1.7 billion.[16]

Interestingly, traditional financial services have been a driving force in the IT industry (for at least 20 years), to the extent that some of them can also be considered tech companies. For instance, in 2014 approximately one third of Goldman Sachs' 33 000 full-time staff are engineers and programmers – more than

[10]See Accenture, 2018, *op. cit*.
[11]See KPMG, Press release 'Global fintech funding tops US$31B for 2017: KPMG's Pulse of Fintech report', 13 February 2018.
[12]Insurtech refers to the use of technology innovations designed to increase efficiency of current insurance industry models.
[13]Blockchain is a decentralised digital ledger of economic transactions that can be programmed to record financial transactions (and more) by allowing digital information to be distributed but not copied or changed. Data packages, 'blocks', are stored in a linear chain. This technology was originally devised for the digital currency Bitcoin, but today presents a number of other potential uses.
[14]See KPMG 2018, *op. cit.*
[15]See Financial Times, Fintechs warned to expect tougher regulation, 25 January 2017.
[16]See IBISWorld.com, Peer-to-Peer Lending Industry Revenue to Grow 37.7% in 2015, 12 May 2015.

Twitter or Facebook.[17]

Alongside their growing prospects, FinTech firms might constitute possible threats to traditional banks' profitability, as explored by Gobbi, for instance.[18] By leveraging the changes brought about by digitalisation, FinTech firms are providing services that have historically been the core business of commercial banks, and a large source of their earnings. Furthermore, by using remote distribution channels, they have contributed to lowering switching costs (the costs banks' customers incur when switching to competitors) that have granted the incumbent bank oligopoly power so far, as well as related profits. Gobbi argues that it is probably too early to establish whether these circumstances constitute real threats for traditional banks, but, as also Dermine remarks, they are likely to have an impact on markets for services whose production implies highly intensive data processing, such as payments, standardised consumer credit, brokerage of securities, and passively managed funds.[19] Banks are actively responding to these challenges, either trying to reproduce the FinTech firms' models (i.e. by setting up online lending platforms), or outsourcing part of their business processes to FinTech firms.[20]

3. The Single European Act (1986) and the Maastricht Treaty (1992) set the framework for the establishment of a single market for financial services in the EU and an ever increasing number of financial services directives and regulations. Notwithstanding, no single overall legislation covers all aspects of FinTech yet. FinTech companies who provide financial services (e.g. lending, financial advice, insurance, payments), should comply with the legislation applicable to any other firm offering similar services. Therefore, depending on the activity carried out, different

---

[17]See Business Insider UK, Goldman Sachs is a tech company, 12 April 2015.
[18]See GOBBI, The troubled life of the banking industry, Wolpertinger Conference 2016, European Association of University Teachers of Banking and Finance, University of Verona, 2 September 2016.
[19]See DERMINE, Digital banking and market disruption: a sense of déjà vu?, in Banque de France (Ed.), Financial Stability in the Digital Era, Financial Stability Review, April 2016, 17-24.
[20] See Banking Technology March 2017 issue.

laws apply, such as Directive 2000/31/EC (e-commerce)[21], Directive 2002/65/EC (distance marketing of consumer financial services)[22], Directive 2009/110/EC (electronic money)[23] or Directive (EU) 2015/2366 (payment services)[24].

The Payment Services Directive (PSD) deserves a closer look. PSD I (Directive 2007/64/EC)[25], adopted in 2007, introduced more competition in the payment services market within the EU, and established the legal basis for the single European payments area (SEPA).While SEPA was successful in harmonising card and bank-to-bank payments, mobile and online payments remained fragmented.

In July 2013, the European Commission announced a new financial regulation package including the updated Payment Services Directive, the so-called PSD II (Directive (EU) 2015/2366), [26] and a proposal for regulation on interchange fees for card-based payment transactions (Regulation (EU) 2015/751).[27] Michel Barnier, Internal Market and Services Commissioner at the time, justified the new rules by, inter alia, the fact that the fragmented rules in the EU payment industry create costs of more than 1 percent of EU GDP or €130 billion a year. According to Barnier, the implementation of PSD II could boost the European economy, as the proposal seeks to 'promote the digital single market by making internet payments cheaper and

---

[21]See Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce').

[22]See Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC.

[23]See Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC.

[24]See Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[25]See Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC.

[26]See Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[27]See Regulation (EU) 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions.

safer, both for retailers and consumers. And the proposed changes to interchange fees will remove an important barrier between national payment markets and finally put an end to the unjustified high level of these fees'.[28]

PSD II came into force on 12 January 2016. The deadline for implementation into Member States' national law was 13 January 2018. The new directive is designed to respond to technological changes in the payments industry.[29] It aims to make payments and money transfers more secure and less expensive. At the same time, it also addresses differences in implementation of PSD I by Member States which were perceived as distorting competition. Under PSD II, the definition of payment services has been expanded, and the diversity of traditional payment service providers (PSPs), such as banks and financial institutions, has been increased. Account information service providers (AISPs), as well as payment initiation service providers (PISPs) (e.g. e-commerce payments) are all classified as third party service providers (TPPs) in PSD II.

Under the new directive, new payment service providers are subject to the same rules as other payment institutions. In return, banks are obliged to provide API (Application Programming Interface) access to third parties.[30] Non-banks will then have the right to access customers' data (provided that they have the customers' permission).[31]

In this context, some experts argue that PSD II will level the field, and that FinTech start-ups might profit disproportionally over traditional payment stakeholders. They also think that this might be a key change towards the creation of an open banking system.[32] There is, however, criticism on PSD II. Darolles notes that

---

[28]See European Commission, Press release 'New rules on Payment Services for the benefit of consumers and retailers', 24 July 2013.
[29]See William Fry, The Fintech and Payments Revolution of PSD2: What Do I Need To Know?, April 2016.
[30]API enables software programs to interact with other software and allow platform to connect with the market (for e.g. information sharing, real-time price quotations, trade executions, etc.).
[31]See Financial Times, New EU laws legitimise fintech challengers, 26 September 2016.
[32]See PFUETZE, Payment Service Directive II – A glimpse at the EU's FinTech regulation effort and its implications, Paris Innovation Review, 17 March 2016.

access to bank account information raises the question as to who should pay for the infrastructure needed for such interconnectivity. The most crucial issue raised is that of security, as the sharing and use of client identification details heightens the threat of cyber-attacks. If a payment services provider is hacked, it could unintentionally propagate the attack to all its clients' banks. Banks are thus calling for tighter security regulations for newcomers, and raising concerns about the authentication systems they use.[33]

One particular Regulatory Technical Standard (RTS), concerning the processes and data structures of the communication between the parties, is key to achieving the objective of the PSD II of ensuring consumer protection, enhancing competition and promoting innovation in the retail payment market across the European Union. According to Article 98 of PSD II, the European Banking Authority (EBA) drafted such RTS in close cooperation with the European Central Bank (ECB). The European Commission adopted its final proposal for the RTS in November 2017.[34] Subject to the agreement of the European Parliament and the Council, the RTS is due to become applicable around September 2019. According to the new rules, banks will have to put in place a communication channel that lets TPPs access the data they need. This communication channel will also allow banks and TPPs to identify each other when accessing customer data and communicate through secure messaging at all times. Banks may establish this communication channel both by adapting their customer online banking interface, or by creating a new dedicated interface. Should they opt for the latter, banks will have to provide the same level of availability and performance as the interface offered to, and used by, their own customers and provide the same level of contingency safeguards in case of unforeseen unavailability.

[33]See DAROLLES, The rise of fintechs and their regulation, in Banque de France (Ed.), Financial Stability in the Digital Era, Financial Stability Review, April 2016, pp. 85-92.
[34]See Commission Delegated Regulation (EU) 2018/389 of 27 November 2017supplementing Directive 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication, C(2017) 7782, 27 November 2017.

4. Data protection and data ownership are among the main issues arising from the rapid development of FinTech. Consequently, when setting out policies for FinTech, the more general phenomenon of 'Big Data' must be considered. Some experts say that the current EU legislation on data protection, competition and consumer protection is noticeably lacking in its definition of 'big data', creating a regulatory blind spot which needs addressing.[35] On the issue of data protection (in the 'personal data protection' sense), the EU legal framework was firstly set by Directive 95/46/EC[36] on the protection of individuals with regard to the processing of personal data and on the free movement of such data. This directive was replaced by Regulation (EU) 2016/679[37], the so-called General Data Protection Regulation (GDPR).

After two years since its entering into force on 24 May 2016, the GDPR is fully applicable as of 25 May 2018. The new rules, among others, include provisions on:

- a right to transfer personal data to another service provider (data portability);
- a 'clear and affirmative consent' for the processing of private data by the person concerned;
- the right to know when personal data has been hacked (and corresponding obligation for companies to notify data breaches);
- increased transparency, ensuring, for instance, that privacy policies are explained in clear and understandable language;
- stronger enforcement and fines of up to 4 percent of firms' total annual turnover, as a deterrent to breaking the rules;
- data protection by design and by default, i.e. embedding data protection values through innovative methods and technical solutions from the beginning

[35]See PATTERSON, Fintech Firms, Consumers Grapple Big Data Regulation in Latest Consultation, Finance Magnates, 20 December 2016.

[36]See Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

[37]See Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation).

is also an essential principle of the new law.

Businesses are expected to benefit from the single set of rules across the EU. Thanks to the 'one-stop-shop', companies only have to deal with one single supervisory authority – rather than 28 different authorities. This is expected to save around €2.3 billion every year.

The European Supervisory Authorities (ESAs)[38] on financial issues evaluated the FinTech specific additions to the GDPR and other general consumer protection regulations. The Joint Committee of the ESAs unveiled a public consultation paper, which touches, inter alia, on the potential benefits and risks of big data use. The purpose of the consultation was for the ESAs to understand what the big data phenomenon effectively means for consumers and financial institutions, among others.[39]

In their March 2018 Joint Committee Report on Big Data[40], the ESAs point out that the legislative requirements existing in these areas 'constitute an already quite solid framework to mitigate the risks identified in the context of this work.'[41] The ESAs also note that this framework will be further strengthened with the entry into application of several key pieces of legislation in the financial sector as well as in the data protection sector (notably, GDPR). In this context, the ESAs consider that a legislative intervention at this point would be 'premature, given that some key pieces of legislation are yet to be implemented or have just entered into application.'[42]

However, the ESAs believe that it is important to coordinate better in order to ensure that requirements are effectively complied with. The ESAs suggest an indicative list of arrangements and behaviours that could be followed by financial institutions to develop good practices on the use of Big Data. Items in three keys area

---

[38]These are the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

[39]See ESA, Joint Committee Discussion Paper on the Use of Big Data by Financial Institutions, JC/2016/86, 19 December 2016.

[40]See ESA, Joint Committee Final Report on Big Data JC/2018/04, 15 March 2018.

[41]See ibid., p. 6.

[42]See ibid., p. 7.

are proposed, namely (i) robust Big Data processes and algorithm, (ii) consumer protection and (iii) disclosure on the use of Big Data.[43]

At global level, the International Financial Consumer Protection Organisation (FinCoNet) has been working on the emerging consumer risks in the field of payments, and recently published a report on online and mobile payments.[44] The report focuses on how regulators and supervisors are addressing emerging risks, particularly security risks, and are keeping up with the pace of innovation. In a 2017 report[45], FinCoNet also addresses the growth of short-term, high-cost lending provided through digital channels, which has resulted in new challenges for supervisory authorities around the world as well as for consumers. The report represents the output of a detailed survey of supervisors in 25 jurisdictions, undertaken in March 2017, as well as a review of international literature published on this topic to date. Based on the findings of this report, FinCoNet has identified a number of topics that are particularly relevant for supervisors to consider in their design of a responsible lending regime in relation to the digitalisation of short-term, high-cost consumer credit. Those range from comprehensive regulatory scope to appropriate oversight tools and also include consumer access to recourse mechanisms, targeted prevention of consumer over-indebtedness and, last but not least, requirement for human interaction. FinCoNet is going on with the analysis of this trend and is working on the development of guidance for supervisors. The development of such guidance will also imply consultations with relevant stakeholders, including consumers' representatives and international organisations and standard-setting bodies. FinCoNet also provides a permanent forum for supervisory authorities to engage with and learn from others on how best to meet these challenges. In this context, in addition to the ongoing work on high-cost lending

---

[43]See ESAs 2018, cit., 7.

[44]See FinCoNet, Online and mobile payments - An overview of supervisory practices to mitigate security risks, January 2018.

[45]See FinCoNet, Report on the Digitalisation of Short-term, High-Cost Consumer Credit, November 2017.

and risk-based supervision in a digital age, which were identified as priority themes for 2017-2018,[46] FinCoNet is starting new projects to look at issues relating to financial product governance and culture, and financial advertising, which are important topics for supervisory authorities charged with the protection of financial consumers.[47]

In most countries, a consumer protection framework, which can be based on domestic (national legislation/codes), regional (European directives) or international standards (OECD/G20 principles), is already in place. Even where such frameworks are present, the OECD/G20 high level principles on financial consumer protection, [48] developed by the G20/OECD Task Force on Financial Consumer Protection, set out clearly the key elements necessary to protect consumers of financial services. The G-20/OECD Task Force has identified FinTech as one of the key areas for examination.

5. FinTech makes it possible to expand services and bring them to more people, thus boosting competition. The digitization process, however, could also 'exacerbate financial volatility' and increase risks, including the operational one. In addition, it makes infrastructures more vulnerable to cyber-attacks and, due to the increasing complex interconnectivity of (global) financial services, such vulnerability might affect the whole system. The European Commission identified, in its digital single market mid-term review in May 2017, cyber-security as one of the key three areas for further work.

On 13 September 2017, the Commission adopted a cybersecurity package. The package builds upon existing instruments and presents new initiatives to further improve EU cyber resilience, deterrence and response. Within it, the Commission has

---

[46]See FinCoNet, Communiqué, FinCoNet announces its programme of work for 2017/18, 20 January 2017.

[47]See FinCoNet, Media Release, FinCoNet looks forward to a productive year in 2018, 23 January 2018.

[48]In February 2011, the G-20 called on the OECD, the Financial Stability Board (FSB) and other relevant international organisations to develop common principles on consumer protection in the field of financial services. These principles were endorsed at the G20 meeting on 14-15 October 2011.

put forward a legislative proposal which foresees a permanent mandate for the European Union Agency for Network and Information Security (ENISA) and the creation of an EU certification framework for ICT security products ('the cybersecurity act').

Furthermore, the Directive on the Security of Network and Information Systems (NIS) has formally created a network of Member State Computer Security Incident Response Teams (CSIRTs). In order to assist Member States in implementing the NIS Directive, the Commission proposes to transform ENISA into a stronger EU Cybersecurity Agency with a permanent mandate and bigger amount of resources.

The Commission is also proposing the creation of a European cybersecurity certification framework which is expected to deliver numerous individual European cybersecurity certification schemes, i.e. clear descriptions of security requirements to be met by covered products, systems or services. Though the use of this European cybersecurity certification scheme will be on a voluntary basis as it is non-mandatory.

6. Greater attention in terms of consumer protection and cybersecurity is required when it comes to virtual currencies[49] and their supporting blockchain technology (also referred to as 'distributed ledger technology', DLT)[50]. The European Union has not yet adopted any specific regulation thereon.[51] According to Ozelli, the EU has a contradictory stance towards blockchain and cryptocurrencies: 'Undeniably, on the one hand, the EU has been pushing for global cryptocurrency regulation at the G-20 level, coordinated by the Organization for Economic Cooperation and Development (OECD). But on the other hand, the EU also took the lead in proposing an EU-wide digital tax ahead of the OECD, by proposing brand new taxable nexus, 'digital presence' or 'virtual permanent establishment' concepts which are not addressed in current tax treaties. All the while, EU member state cryptocurrency

[49]See note 5.
[50]See note 13.
[51]See EPRS, Virtual currencies: Challenges following their introduction, PE 579.110, March 2016.

classifications for income tax and for VAT purposes, as well as their taxation, vary widely from member state to member state, with cross-border tax applications as detailed in current tax treaties uncertain. These multiple tax issues, compounded with the individualized implementation of EU's anti-money laundering laws by member states, could pose a barrier to pan-European blockchain implementations by creating compatibility issues with various tax authorities as well as financial regulators.'[52]

In this context, the Bank of International Settlements (BIS) concluded in its annual economic report that cryptocurrencies could not scale to function as legal tender. On the other hand, blockchain technology could be suitable for cross-border payment transactions, as it would enable greater efficiency and speed in value transfer.[53]

In their meeting of March 2018, the G-20 finance ministers and central bank governors also acknowledged that virtual currencies are not legal tenders, but rather a new digital-asset-class. Therefore, the G-20 committed, inter alia, to implement the Financial Action Task Force's (FATF) anti-money laundering standards as they apply to crypto-assets to mitigate concerns over security, consumer protection, and financial crime.

Following the G-20 meeting, the EU updated its anti-money laundering directive for crypto-asset beneficial ownership disclosure rules in April 2018. These changes will be transposed into the Member States' laws by January 2020, allowing Member States some leeway for taking account national preferences. Banks are free to move capital across EU (and beyond), but checks on money laundering remain largely in the remits of national authorities. Some Member States therefore call for a new body on anti-money laundering at the EU level, while others favour giving more power to the existing EU financial regulators, e.g. the European Banking Authority

[52]See OZELLI, Virtual Drivers of Real Economic Growth: The EU's Complex Tax Policy Strategy, Bloomberg Tax International Journal, 6 July 2018, p. 2.
[53]See BIS, V. Cryptocurrencies: looking beyond the hype, in Annual Economic Report 2018, 24 June 2018.

(EBA).[54]

In its resolution of 26 May 2016, the European Parliament[55] stressed that virtual currencies and blockchain have the potential to positively contribute to citizens' welfare and economic development, including in the financial sector. However, they entail risks which need to be addressed appropriately so as to enhance trustworthiness. A proportionate regulatory approach at EU level was therefore required, not to stifle innovation or add superfluous costs to it at this early stage, while taking seriously the regulatory challenges that the widespread use of virtual currencies and blockchain might pose. The resolution pointed out that existing key EU legislation - such as the European Market Infrastructure Regulation (EMIR), the Central Securities Depositories Regulation (CSDR), the Settlement Finality Directive (SFD), Markets in Financial Instrument Directive and Regulation (MiFID/MiFIR), UCITs and the Alternative Investment Fund Managers Directive (AIFMD) - 'could provide a regulatory framework in line with the relevant activities carried out, irrespective of the underlying technology'. However it is observed, that more tailor-made legislation might be needed. The Parliament also called on the Commission to promote a shared and inclusive governance of the distributed ledger technology.

New technologies can make a substantial contribution to overcoming barriers that still hinder the full integration of market infrastructures, which is one of the factors on which the success of the capital markets union (CMU)[56] depends. Possible benefits of distributed ledger technology (DLT) applied to securities markets are

[54]See OZELLI 2018, op. cit., p. 4.
[55]See European Parliament, Resolution of 26 May 2016 on virtual currencies, 2016/2007(INI).
[56]See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on building a capital markets union, COM/2015/0468, 30 September 2015; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the mid-term review of the capital markets union action plan, COM(2017) 292, 8 June 2017.

listed in a European Securities and Markets Authority (ESMA) consultation paper.[57] DLT could speed clearing and settlement by reducing the number of intermediaries involved in the process and by making the reconciliation more efficient.[58] It could also facilitate the recording of ownership of a variety of securities and the safekeeping of assets, by promoting a unique reference database. Possible ambiguity of contract terms could also be reduced by means of DLT. Automated processing of corporate actions, which are one of the areas where further harmonisation is sought to fully benefit from the Target2-Securities (T2S) platform, may increase. According to respondents to the consultation paper, DLT could even be used to directly issue digital securities and track their ownership, potentially reducing fragmentation and transaction costs for capital financing. While consulting stakeholders on potential benefits of DLT, however, ESMA underlined the key risks associated with this technology, and stressed that firms willing to use DLT should be aware of the existing regulatory framework. Experts such as Pinna and Ruttenberg also explored possible DLT applications to post-trading activity. While recognising the improvements this technology could bring at different steps of the post-trading process, the authors nevertheless state that, 'irrespective of the technology used and the market players involved, certain processes that feature in the post-trade market for securities will still need to be performed by institutions'.[59]

To benefit from the emerging ICT technologies, some 20 EU Member States have created national blockchain innovation initiatives. These initiatives foresee, inter alia, easing foreign direct investment rules, providing funding or asking ICT companies for innovation transfer and support for the build-up of their national infrastructure. However, diverging national rules on the use of blockchain and cryptocurrencies undermine the efficiency of the EU's single market. Setting-up an

---

[57]See ESMA, The Distributed Ledger Technology Applied to Securities Markets. Discussion Paper, ESMA/2016/773, 2 June 2016.
[58]See EPRS, Distributed ledger technology and financial markets, PE 593.565, November 2016.
[59]See PINNA, RUTTENBERG, Distributed ledger technologies in securities post-trading: Revolution or evolution?, ECB Occasional Paper Series, No. 172, April 2016.

EU regulatory framework for blockchain technology and cryptocurrency have therefore become key within the European Union. In this context, 22 out of 28 EU Member States entered the EU Blockchain partnership to share experiences in technical and regulatory fields and to prepare for the launch of EU-wide blockchain applications. Furthermore, a High-Level Group of Innovators has been created to advise the European Commission on supporting entrepreneurs, innovators and scientists in, amongst others, blockchain issues. The Commission also launched the EU Blockchain Observatory and Forum to map key initiatives, monitor developments and inspire common actions.

7. Both the Bank of England and the Deutsche Bundesbank expect more intrusive regulation for banks and FinTech companies that use disruptive technology in financial services, as the use of the technology itself becomes more sophisticated and widespread. According to the Governor of the Banque de France, specific regulations that allow for 'a gradual adjustment of regulatory intensity' may be better suited to addressing risks in the financial technology industry.[60]

Generally speaking, there are two approaches to FinTech regulation: rule-based and principle-based. Rule-based frameworks create clear rules and processes. The compliance obligations are clearly set out, but this can limit the incentive for the supervised entity to do more, because the obligations are perceived as sufficiently comprehensive. From a start-up perspective, this approach is often expensive, as each rule and process needs to be identified and complied with. Principle-based models are flexible, but could create a level of uncertainty as to what exactly is expected in terms of compliance.[61]

Some experts argue that regulators should remain technologically neutral and

---

[60]See Financial stability in the age of digital industry, Introducing speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Paris Europlace International Financial Forum, New York City, 18 April 2016.

[61]See BRUMMER, GORFINE, FinTech: Building a 21st-Century Regulator's Toolkit, Milken Institute – Centre for Financial Markets, 21 October 2014.

focus on the outcome of a technology. They suggest a 'wait-and-see' approach, allowing regulators to learn whether the market will adopt the technology, and draw on historical data as to the risks a specific technology creates.[62]

Most FinTechs, however, prefer the more flexible compliance obligations of a principle-based regulatory regime. Under this regulatory approach, more focus is given to the spirit of a regulation, rather than 'box ticking'. The UK has taken this approach and is widely regarded as one of the most welcoming countries for FinTech. In spring 2016, the UK's Financial Conduct Authority (FCA) introduced, inter alia, a 'regulatory sandbox'.[63] In this context, the FCA expanded its responsibilities to advice and support, and introduced temporary permits (enabling start-ups to delay full compliance by two years). Furthermore, the FCA not only initiated a public consultation to understand and explain the regulatory hurdles faced by FinTech, but also put in place 'Project Innovate', which contains an Innovation Hub and Advice Unit for FinTechs and innovative businesses. Private parties subject to this regime may have a certain degree of discretion in implementing the regulation.

Rules-based regulatory regimes

Potential positives	Potential negatives
Certainty and predictability, including with respect to future enforcement	'Check-box' forms of compliance that strategically evade the underlying purpose of the regulation
Clear communication of steps for compliance	High internal costs of compliance

Principles-based regulatory regimes

Potential positives	Potential negatives
Executive-level management involvement in incorporating regulatory principles into business models	Uncertainty and the risk of unpredictable post hoc application or arbitrage
Flexibility and innovation in the face of 'rapidly changing	Concerns over fairness/bias in application

[62]See ARNER et al., 2015, op. cit., p. 33.

[63]Regulatory sandboxes can be considered 'safe spaces' in which businesses test – for a limited time and without being exposed to the normal regulatory burden – their models, products and services.

		environments’	
Ensures specific behaviour	Deterrence with respect to innovation	Speed in the regulatory process	Inadequate deterrence of specific problematic behaviour or activities
Uniform treatment of regulated entities	Frequent disconnect between the purpose of the regulation and the actual regulatory outcomes	The centrality of guidance and evolving norms/best practices	Over-reliance on current norms and practices
	Obsolescence		

Source: Brummer & Gorfine 2014, 7.

In contrast, there is the German approach. According to Dombret, Germany’s financial regulatory logic is equally applicable to any innovative, IT-based business. The main reason is that regulation is rigorously built on risk orientation and that the principle of ‘same business, same risk, same rules’ applies. Technical implementation issues are not taken into consideration when defining permissions and responsibilities (‘technical neutrality’): ‘Banking without banks – in the sense of a financial intermediary providing all the services of a bank without being treated as a bank by supervisory authorities – is therefore irreconcilable with existing financial regulation’.[64]

In this context, Arner et al. suggest to considering rule-based or principle-based frameworks as not mutually exclusive. They argue that a rule-based framework can make start-ups more attractive to investors, due to better legal predictability. Start-ups could increase their access to sufficient financial resources. As a consequence the higher costs and complexity associated with a rule-based approached might be understood as a benefit, both for the company and the

[64]See DOMBRET, Beyond technology – adequate regulation and oversight in the age of fintechs, in Banque de France (Ed.), Financial Stability in the Digital Era, Financial Stability Review, April 2016.

investor.[65]

8. At the EU level, there have been a number of attempts to collect FinTech related information and data and to explore how FinTech companies can address cross border take-up of financial services and financial inclusion.

In December 2015, for instance, the European Commission published its ‘green paper’ on retail financial services, which is seen as an effort on the part of the EU to take a more holistic view of the FinTech sector.[66]

In November 2016, a Financial Technology Task Force (FTTF) was set up, which looks at a number of issues affecting FinTech. The March 2017 consultation on new technology and its impact on the European financial services sector helped the Commission to identify new issues that need to be integrated in the capital markets union (CMU) policy framework. In particular, it provided the Commission with valuable inputs on whether different, more proportionate licensing arrangements for FinTech activities are needed; and how to support FinTech firms, registered in one EU Member State, carrying out cross-border business without the need for further authorisation in other EU countries ('passporting'). Thus, in the framework of the CMU Action Plan on CMU mid-term review, as part of a comprehensive approach to enable FinTech, the Commission had committed to assess the case for an EU licensing and passporting framework for FinTech activities.[67]

On 17 May 2017, the European Parliament voted an own-initiative report on the influence of FinTech on the future of the financial sector, presented by Rapporteur Cora van Nieuwenhuizen (ALDE, Netherlands). The resolution focused on six main areas: data, cybersecurity, blockchains, interoperability, financial stability as

---

[65] See ARNER et al., 2015, op. cit., p. 36.

[66] See European Commission, Green Paper on retail financial services. Better products, more choice, and greater opportunities for consumers and businesses, COM(2015) 630 final, 10 December 2015.

[67] See European Commission 2017, Communication on the mid-term review of the capital markets union action plan, cit.

well as financial and IT skills.[68] The large consensus obtained by the report stems from its balanced tone. While the report repeats that FinTech companies contribute positively to the development of financial intermediation, it also stresses that these companies might pose risks to financial stability; automation may disrupt existing patterns of employment; clear rules on data ownership should be established in order to guarantee the protection of the consumers; crowdfunding and peer-to-peer lending provide less information about their balance sheets than the banking sector. In the plenary vote in May 2017 in Strasbourg, Members of the European Parliament urged the European Commission to come up with a set of rules that would enable FinTech to develop ’a comprehensive Action Plan in the framework of Capital Markets Union and Digital Single Market’.

Against this backdrop, the European Commission presented an Action Plan on FinTech in March 2018. The Action Plan sets out 19 steps to promote innovative business models, the uptake of new technologies (such as blockchain, artificial intelligence and cloud services), to increase cybersecurity and the integrity of the financial system, and to enhance further investor, consumer and data protection alike. Furthermore, the Action Plan aims to promote innovation and regulatory certainty. In this context, the introduction of so-called ‘regulatory sandboxes’ is foreseen, where (national) supervisors apply rules to FinTech firms in a more flexible way. Also the introduction of a new ‘EU FinTech Laboratory’ is on the agenda to increase knowledge of technologies among EU and national authorities.

In this context, the Commission also put forward new rules to help crowdfunding platforms scale-up across the EU's single market. In March 2018, a proposal for a regulation was adopted, which aims to introduce an optional EU regime enabling crowdfunding platforms to easily provide their services across the EU Single Market. Instead of having to comply with different regulatory regimes, platforms would have to comply with only one set of rules, both when operating in

---

[68]See European Parliament, Resolution of 17 May 2017 on FinTech: the influence of technology on the future of the financial sector, 2016/2243(INI).

their home market and in other EU Member States. This is expected to widen the pool of investors and the number of projects to pick from, as well as provide legal certainty as regards the applicable investor protection rules.[69] The accompanying proposal for a directive amends the scope of Directive 2014/65/EU (MIFID II) by adding crowdfunding service providers authorised under the proposed Regulation to the list of exempted entities to which the scope of the Directive does not apply.[70]

The Commission's Action Plan on FinTech also includes several mandates for the European Supervisory Authorities (ESAs). In particular, the Commission invites the ESAs to conduct further analysis on FinTech facilitators set up by national supervisory authorities, to identify best practices and, where appropriate, to issue guidelines on these facilitators. The Commission also encourages competent authorities to take initiatives to enable innovation on the basis of these best practices and invites the ESAs to facilitate supervisory cooperation and consistency of supervisory practices.

Role of supervisors is crucial. In fact, not only can they make a substantial contribution to set a fit-for-finTech regulatory environment by providing appropriate guidance based on best practices, but also areas exist where the development of RegTech[71] solutions by supervisors would be an effective way forward to respond to overall regulatory expansion in the financial sector.[72] As pointed out by Steven Maijoor, 'financial innovation – including FinTech – often evolves is the notion of a 'regulatory dialectic'. Market participants take into account existing rules and regulations when they innovate. In response, authorities may seek to amend the

[69]See European Commission, Proposal for a Regulation on European Crowdfunding Service Providers (ECSP) for Business, COM(2018) 113.
[70]See European Commission, Proposal for a Directive amending Directive 2014/65/EU on markets in financial instruments, COM(2018) 99.
[71]See note 8.
[72]See COLAERT, RegTech as a response to regulatory expansion in the financial sector, Draft March 2017.

regulatory framework, which may then prompt further innovation, and so on'.[73]

FinTech is proving to have the potential to accelerate the evolution towards a cooperative supervisory model, in which supervisors guide firms towards adequate and proportionate compliance with the regulatory framework and firms in turn deliver essential input for the development of efficient guidelines, best practices and technical solutions. Will FinTech pave the way for a 'Lamfalussy[74] 2.0' era?

---

[73]See MAIJOOR, Keynote Address: A Measured Approach to Fintech, Afore Consulting's Second Annual FinTech and Digital Innovation Conference: Regulation at the European Level and Beyond, ESMA71-319-70, 27 February 2018.

[74]See Committee of Wise Men, Final Report of the Committee of Wise Men on the Regulation of European Securities Markets, 15 February 2001.

CIVIL LAW CONCEPTION OF THE "VECTOR OF INTERESTS" AS A MEANS TO PROVIDE THE BALANCE OF PRIVATE AND PUBLIC INTERESTS (GLANCE FROM RUSSIA)

Aleksey Pavlovich Anisimov * - Vladimir Alekseevich Babakov ** - Evgeniy Valerievich Vavilin ***

ABSTRACT: *This article expounds the idea that in the economic life of a society both public and private interests can be implemented. In Russia, an integrated theory concerning the way these different interests should be regulated has not been developed yet. The Authors explain their "vector of interests" theory regarded from a civil law perspective proving that such theory allows to regulate and balance public and private interests, leaving the latter to freely expand within the limits of law. The article also explains the effects of such "vector of interests" theory through the example of organizational and financial provisions of making the capital repair of the common property in multiple dwellings. Conclusions and final recommendations could be useful to adopt law provisions aimed at managing the relationships between different interests.*

---

*Professor of the Department of Land and Environmental Law, Saratov State Law Academy (Russian Federation), Doctor of juridical sciences, e-mail: anisimovap@mail.ru

**Associate professor of the Civil Law department, Saratov State Law Academy (Russian Federation), Candidate of juridical sciences, e-mail: vladbabakov@yandex.ru

***Vice Rector for Academic Affairs and Research, head of Civil Law department, Saratov State Law Academy (Russian Federation), Doctor of juridical sciences, e-mail: evavilin@yandex.ru

1. The matter of the balance of interests has always been crucial in the legal analysis of Russian and world scholars. The focus on such matter depends on the fact that any legal relationship cannot be considered without considering the single interests of the participants, as according to them the activation of their actions must happen gradually. Should such actions not be provided, the development of the relationships between different subjects can be called into question, in absence of mutual or individual interest (or being such interest fictitious or vicious). To bring the reasons of any legal activity within the framework of rights and duties enable to state that legal relationships (in the post-Soviet legal scholars) are the consciously performed model of behavior of will and interest. This definition can be considered urgent only when the great majority of the subjects have an idea on the goal of their rights and duties' realization.

This is possible only if such construction is also reflected in law provisions and the goal of each right and duty, underlying the link between public and private interests, is explained. Considering that interests may pertain both to collective and individual sphere, the essence of any legal relationships is represented by the *balance* of interests (Sharaeva 2015).

This tramline has a special importance when we talk about the participation of the State in economic relationships. In fact, restrictions imposed by the State (if reasonable) to grant and maintain the order allow to consider the interests of the society as a whole.

In the light of the above, the development and realization of the "vector of interests" theory in Russia, and other Commonwealth of Independent States, is crucial because aimed at supporting the interests in different spheres of law (Babakov 2015).

The main issue is that public interests do not overlap with private interests and this is why the *balance* of values shall be the guideline of the legislative activity. From a general standpoint the main value of a society depends on law; for example in

Russia the recognized system of values is reflected in the Constitution of Russia. But this document shall not be considered the only source of the location of the "vector of interests", whose content can be recovered in the social development and not in the principles fixed in the Constitution of the Russian Federation.

It shall be considered that in Russia the idea of common weal represented in legislation can be much different from the one acknowledged by people (Osipov 2016).

Such difference explains the polarity between the contents of the several interests and may be challenging because the lack of efforts to find a composition between interests, as well as the provision of legal protections for the stronger party, is very common and may certainly represent a problem to be solved.

Consequently, the activity aimed at reaching the balance between public and private interests (Medvedev 2015) must be carried out after a proper analysis of the vectors' directions carried out by experts. The search of ratability, reaching the compromise necessary for the society mark off the developed society in which the vector basics of the main directions of the economic life are not only adopted but they induce the economic development of the state and raise the well-being of citizens.

Legality and justice usually represent the achievement of a reasonable balance of interests, considering that fixed vector basics of the development start must be the result of a process towards the balance of interests, that allows to consider functions and tasks of the State and its community from a new perspective (Batova, Belousov 2014). To prevent abuses between the members of the society, the order of priority between different interests shall be laid down by law, as the only way to grant the balance between public and private interests.

2. Public and private interests are achieved in the economic life of the State. Let's try to cast a look at the issue anticipated in the Introduction of this article. The example is taken from Russian Civil law (Ryzhenkov, 2017). All the inconsistencies

between the abovementioned interests clearly appear (Vavilin, 2017) and such antagonism has been clearly pointed out since the first application of the Civil Law (Aksenova 2007; Maltsev 2004; Pakhman 1882) and served as the basis to create two theories aimed at addressing the abovementioned inconsistencies. The first, the "material theory", relies the division of law into private and public on the difference between the legal relationships involved (Dernburg 1906); the second, the "formal theory", bases such division on the difference between the interests of private and public subjects that the different branches are called to protect (Shershenevich 1910).

The work of T.S. Yatsenko may be used as an example of the analysis of the contradictions and dialectical interdependence and antagonism between the different interests protected by public and private law (Yatsenko 2016). His work illustrates, on the one hand, the existence of public interests in Civil law and, on the other hand, underlines the objective determinacy of their protection. The Author concludes that public interest represent a crucial element in any branch of law, asking which interests law must represent and protect and where is the balance between them; but such a question can't be solved without pointing the way to seek these interests, that shall be defined by law.

If the pursuit of public interests depends on the will of public subjects then for their realization the identification of specific checkpoints is necessary. These checkpoints must plot a unified vector of development, which separates them from "false public" interests, which are pursued only for the achievement of private interests.

However, in Russian legislation there are no references from which identify such interests. According to V.M. Syrykh, even if the existence of civil society itself is out of doubt, when it comes to solve a conflict between State and population, to identify the specific features of the State and the source of the sovereignty, to define rights of civil society as a subject of legal relationships, then civil society becomes a shapeless, undefined and smooth subject. "*It is symptomatic that Russian legislator* *does not consider the civil society as the subject of the Civil law*" (Syrykh 2007).

Nowadays there are no theories clarifying how law should represent interests of these subjects. Such situation can be explained because in any matter the comprehension of any issue in its completeness gradually comes from the observation of the empirical data to the theoretical knowledge of substance and necessity. Such way of acquiring knowledge is stipulated by the fact that objective laws do not exist in their pure form but display themselves on the whole of concrete phenomena and processes. The searching for a balance between public and private interests in law does not give exception; accordingly, Karl Marx states that the task of scientific knowledge is that "apparent and only existing in the phenomenon of development converge into actual inner development" (Marx, Engels 1961).

The discover of these objective law leads to the acknowledgment that – in certain spheres of legal relationships – public interests shall prevail over private ones; however, such priority is not reflected in the civil law provisions. In line with the thought of I.N. Senyakin, according to which "*legal principles always reflect by means of giving proper legal form to the state priority and objective laws of the public society development*" (Senyakin 2007) the Russian law does not recognize as a priority the pursuit of public interests.

Therefore, according to Russian Civil Code, the vector of development of business activity is not directed towards the realization of public interests. In fact, the definition of "business activity", contained in art. 2 CC RF – "*[activity] independent, realized at its own risk activity, directed at regular profit earning from beneficial enjoyment, sale of goods, carrying out work or service accomplishment to the persons registered as those in accordance with the established legal procedure*" – does not suppose any social function of the business activity.

Another example, confirming that business activity in Russia is not directed towards the realization of public interests, is the lack of any regulation of natural resources. The Constitution states that "*land and other natural resources are employed and protected as the living and activity base of the people inhabiting* *certain territories*" (art. 9 of the Constitution of the RF); therefore, it would be logical to believe that the allocation of such resources should meet the interests of the entire society, being under its control , and not the interests of single persons. As shown, there is a need for specify the instruments to implement these rights. Coming back to the argument of V.M. Syrykh (about the absence of the civil society within the subjects of civil law) it can be said that even if there are vectors towards the realization of public interests there is a lack of will of the legislator to pose such a question.

From our point of view the problem of reflecting public and private principles in law should come down not to the manifestation of their contradiction let it be the wish to resolve differences, the situation when the public interest is not necessarily satisfied by means of public-legal norms – it can be achieved by means of public law and vice versa but to the creation of the single vector of public, state and social interests and to the expression of the vector in law.

According to the above, the vector of interests should be directed towards the realization of public interests, considering that private interests can be realized in a non-systematic way. Nevertheless, according to the experience, the pursuit of public interests occurs without the predominated vector's direction and is strictly disciplined with the consequence of the imbalance of the legal regulation and the raise of social tensions (Belousov S.A., Pavlov A.Y., Batova V.N., Kolesnikov 2016). In order to harmonize public and private interests must be understood the way laws are adopted and their hierarchy and then must be granted the effective co-existence of such interests and not try to achieve the identity of them. The most relevant issue of these problems is the absence of a theoretical definition of the concept of "*public interest*", to be defined, according to Russian law and practice, "*in the regular course of business*".

Some questions raising from the current socio-economic situation can be the following. First, if society can't always be personified, is it possible to define its interests and, if so, which are the elements to be considered for the definition of public interests?

Second, if a group of persons can be considered representing the society, then is public interests established without identity of views (interests) of all participants of this society? Third, how to define the differences between public and private interests without the grounded and legislatively fixed hierarchy of these questions?

We'll try to answer all these questions.

3. Public interest has several practical levels of objectivization: it can appear as the will of the most high-powered social group – provisions widely expressed and implemented in law; public interest the bearer of which is the state in civil relations; social interest of this or that social group.

In several provisions of the Russian civil law, public interest constitutes its main object: for instance, provisions aimed at protecting the environment, culture, other values and social groups (*e.g.* religious groups and other public organizations). It should be considered that, if on the one hand, public interest is the object of rules protecting the needs of a group as a whole, on the other hand, under Russian civil law, public interest is not equated to the rights or interests of the individuals constituting any of the aforementioned groups.

Among these, the provisions regulating the use of significant facilities for the community (*e.g.* hospitals, roads, schools) and the removal of anything that hinders regular life in the community (*e.g.* airports close to inhabited areas) should be noticed.

The Civil Code of the Russian Federation views State and the general public interests as "public". A far as its defense is concerned, the legislator sets forth articles 123.4 "Basic provisions about public organizations", 123.8 "Basic provisions about association (union)", 152.1 "Defense of the citizen's image", 152.2 "Defense of the citizen's private life", 242 "Requisition", 451 "Alteration and termination of the contract in connection with the changing of circumstances".

By way of example, a dividing line between State and public interests can be seen in the Town-planning Code, dated 29 December 2004 № 190-FL, where public interest is conceived as the goal and tasks the self-regulated organization shall pursue.

Due to normative uncertainty, semantic non-specificity of the notion remains. The Law № 2124-1 of the Russian Federation, dated 27 December 1991, “About mass media” defines public interest as “the need of society to detect and disclose the threat to the democratic legal state and civil society, public security, environment” (i. 25). This has led practice to directly follow the legislative provisions without detailing nor defining the principles underlying the notion of “public interest” [1].

Resolution №25 of Plenum of the Supreme Court of the Russian Federation dated 23 June 2015 “On enforcement of certain provisions under Section 1, Part 1 of the Civil Code” claims that “public access to and use of any citizens’ image without their consent is admitted by virtue of article 152.1”, that recognizes public interest insofar as the citizen is a public figure (holds a State or municipal post, plays a key role in social life, politics, economics, art, sports or any other significant area), and public access to and use of citizens’ image is allowed in connection to political or public discussions or when the interest to this person is socially relevant.

The Civil Code also views public interests as the defense of law and order and State security, even if, in practice, these are considered to attain to certain groups in society (*e. g.* consumers’ rights protection).

So, more often the priority of the interest of this or that community is decided on a case-by-case rule. For the time being, there is no method for defining the legal value of differently directed public interests. This leads inevitably to conflict of interests. In this respect, it is necessary to define, at doctrinal level, the meaning of “public interest” and best harmonize public and private interests in particular legal relations. Combination of public and private interests has effect both in the Russian

---

[1]See paragraph 25 of the Resolution of Plenum of the Supreme Court of the Russian Federation of 15.06.2010 No. 16 (ed. by 09. 02.2012) "On the practice of courts of the Law of the Russian Federation on mass media" *Reference legal system" Consultant Plus", date of application 10.03.2018.*

Federation Constitution, the Civil Code, the Civil Procedural Code, Arbitration Procedural Code, Criminal Code, Criminal Procedural Code and other normative legal Acts. It is enshrined in international legal acts: art. 23 of the United Nations Declaration on Human Rights adopted in 1948 restricts effectuation of rights of citizens for the purpose of providing decent acknowledgement and respect of rights and duties of other people and meet demands of public order and general welfare.

The goal of such regulation is to provide a set of rights and duties of subjects that guarantee integrity and safety of individual rights and do not infringe upon interests. In order to achieve this goal, a hierarchy of private and public interests shall be established. Domestic doctrine has already been making attempts to understand its ratability.

The legislator has set up a special legal regime for particular objects. It is carried out by means of either absolute or partial withdrawal from circulation some natural objects and natural resources (items 2,3 art. 120 CCRF). At the moment, this problem in civil law is far from being settled. From our point of view in order to achieve a solution at a doctrinal level, it is necessary to take four principles into account:

1. Preferential interests are those connected with natural, life-sustaining activity of the majority of the members of society and relate to the realization of “natural” rights, for they provide citizens with the possibility to realize their natural rights (*e.g.* environmental protection, security, public order). Harmonized, universal interests do exist and are interconnected with the aim of each person to live in a natural life-sustaining atmosphere.

2. They represent the State’s interests dictated by the need to preserve and consolidate national, territorial and cultural integrity of the country.

3. Private interests should be protected: in the bundle of private interests, it is necessary to identify the pressing and less important ones both for the private and the State.

4. These are public and private interests connected with the realization of

rights to do business (the rest of the rights excluding natural rights).

The elaboration of this position encouraged foreign legislation to prefer the interests of the majority, whenever public and private collide. For instance, under Islamic law the principle according to which “a greater harm should be eliminated with a smaller one” applies if any contradiction between the right of the individual and the general welfare arises. The evident priority given to the latter is incontestable in this case (Yaser 2005). On the other hand, in the USA the “public interest law” has increasingly gained attention due to its underlying idea of social justice. In the German legislation contractual freedom is restricted by the obligation of its conclusion, bound form and by a number of other regulatory directions (Zhalinsky, Roericht 2001), in order to protect public interests depending on individual cases.

In light of the above, the basic aim of this section is to point out the necessity of the “vector” and successively highlight the consequent reflection of public interests in civil law, according to which, in the name of the Russian Federation, the State and municipal entities should bear this interest. Serving society, in fact, must be the essence and goal of their tasks. When a State does not pursue the interests which do not meet those of society, surely such an interest cannot be considered as national. Consequently, any current national interest shall be deemed public, converging, in this context, even into social ones. The practical significance of such approach can be seen in the suggested mechanism of interest distribution, that allows one to comprehend whether an interest can be considered as national and distinguish those pursued not in the interest of society as a whole.

4. Item 2 of art. 1 of the Civil Code of the Russian Federation sets out a sequence of interests: civil rights may be restricted according to the federal law insofar such a restriction is necessary for the protection of constitutional principles, morality, health, rights and legal interests of third parties and for the defense of the State itself.

From our perspective, in regulating the activity of enterprises it is necessary to reinforce the mandatory nature of the law whenever there is the possibility of abusing of public interests. Said that, any rejection from enterprise entities to protect the infringed rights or the interests protected by the law should not be subject to the infringement of state interests and interests of the whole society. This issue concerns actions and/or omissions of central and municipal unitary enterprises.

Previously existing legislation bounds State organizations - whose rights have been infringed - to file claims and bring actions against those who violate their rights. For the time being, such provisions have not been set forth yet, thus allowing abuse of rights and for cutting state and municipal property. For example, the head of the unitary enterprise transfer financial means to the accounts of other commercial legal entities (as a rule, “empty shell companies”) in full accordance with absolutely lawful transactions (*e.g.* credit contract, buy and sell agreement, construction agreement, etc.). Even if such a possibility is not ruled under Russian law, in practice unitary enterprises are given the option to not filing actions against the debtor if the latter infringe his/her duties. By way of example, the Directorate of the Federal Service for Supervision in the Sphere of Natural Resource Use for Volgograd Region (Rosprirodnadzor) filed a lawsuit to a limited liability company, “Water delivery supply”, so as to achieve compensation of damages inflicted to the soil plot for the amount of 3.240.000 rb. As can be seen from the case, material accumulated under the waste treatment facilities and, as a result of the drainage activity, biological clearing waste products formed. On 11 October 2015, the pipeline broke, thus polluting the soil plot which was part of Timber Fund.

Compensation of the damages arisen by the violation of item 1, art.78 of the Federal law № 7 dated 10 January 2002 “On protection of the environment” should be requested via a judicial proceeding or carried out of free will or through a court proceeding. Court of the first instance dismissed a claim. The Court paid attention to the fact that the decision of the Court of the general instance established the fact of zero pollution and negative environmental effect as a result of the pipeline rupture on October 10, 2015. Meanwhile the Court of first instance did not take into consideration that, as a result of the examination, harmful substances were found on the polluted soil plot.

In view of the foregoing, Judgment of the Twelfth Arbitration Appellate Court dated 20 September 2016 compelled the respondent to redress the sum equal to 3.240.000 rb. for the harm inflicted to the soil.[2] The fact that the Directorate of the Federal Service for Supervision in the Sphere of Natural Resource Use recognized in this case the right for compensation of the harm inflicted to the State property plays a key role, albeit art. 1064 of the Civil Code, while listing those who are entitled to be redressed, does not include the State in such a group.

It goes without saying, then, that civil and procedural law (particularly art. 4 of the Arbitration Procedural Code) should be amended in order to allow State and municipal unitary enterprises to resort to the judiciary for the protection of their infringed or challenged rights and legal interests.

The issue concerning the release of the private from debts by the State or municipal unitary enterprise in accordance with art. 415 of the Civil Code is similar to the above-mentioned case and item 2 art. 295 provides for such a possibility. Without the consent of the owner - the State or a municipal enterprise - appropriate authorities may gift movable property the state or the municipal unitary enterprise holds as well as the property got by the enterprise due to establishing or allowed to it business activity (item 2 art. 298 Civil Code of the Russian Federation) (Makovsky 1994).

This circumstance gives way to acritical approach, it is difficult to equate the State's (municipal) and private interests. In the above-mentioned example not only are the rights of a single individual infringed, but also those of millions of people are violated. This may serve as an example of abuse of rights.

From our point of view, the specific characteristics of different kinds of property should be taken into consideration (Inshakova, Goncharov, Sevostyanov

---

[2]Resolution of the Twelfth arbitration court of appeal of 20.09.2016 № 12AP-9108/2016 in the case № A12-12928/2016. *Reference legal system "Consultant Plus". Date of circulation 10.03.2018.*

2017). Free enjoyment of rights for debt release should be given only to citizens and commercial and non-commercial organizations. Pursuant to the principle of combination of private (personal) and public interests, the Civil code should be supplemented with the provision that the State and municipal unitary enterprises - the owners of the property according to the law of economic possession - as well as the State and municipal institutions cannot extinguish a debt without the owner's consent. This statement is similar to the provision contained in item 1, art. 576 of the Civil Code of the Russian Federation, according to which the State and municipal institutions are not allowed to cede real-estate assets and movable property without the preliminary consent of the owner (excluding ordinary donations of relatively low price).

In this relation, attention is drawn to the arbitral model, that looks for an optimal balance between public and private interests, experienced by US Courts. Those interests are analyzed on a three-staged basis: at first, all the norms are abstract and not related one another; then these are ranged according to the situation; later on they are distributed (Porat 2006).

Surely, the problem up for consideration should be summarized more widely, growing out of the ordinary grading of interests according to their ranking. Therefore, the correct understanding of the notion of "public interest" and the mechanism with which these are transformed into legal rules is needed. Some scholars lay the emphasis on the epistemological difficulties that arise in understanding the meaning of "public interest", owing to the fact that society can be regarded to as a variety of communities, strata and classes, each of which claims their interests to be truly public (Shayo 2010).

Accordingly, significant becomes the quest to the real "people's will". It should be notices, as well, that there is the need to acknowledge the fact that the question about what body and within what proceedings these or those rules of the Civil legislation are adopted. On a theoretical level, the fact that personal liberty, in its proper sense, is possible only under authentic democracy - when the State, as the embodiment of the political power of the dominating class, does not prevail over civil society (existing either in an embryonic or an artificial condition), and society has the definite priority in relation of State has gained the universal acknowledgement. Transition to such a system of values when civil society creates the real mechanisms of interaction and impact over the State – surely, it is a longstanding but historically predominated process, objectified by unavoidable aspiration upon reaching public institutions of the certain level of development, the new quality of the society.

The essential features of this new status can be seen in the composition of society, specifically in the developed principles of self-organization, self-regulation and control capable to provide not only an optimal balance between private and public interests in law and, first and foremost, the correct understanding of the essence of such interests as it is impossible the effective vector reflection of these principles as both in the rules of law and in law enforcement. And in this new quality the fixed formula of acknowledgement as the supreme value of such a state – a person, his rights and freedoms not as the embodiment of individual, egoistic principles in law, but as the embodiment of an ideal formula – “we are the State” – the formula of interaction of the State and civil society.

Multidimensionality suggests to agree with the following conclusion: whenever there is a contradiction between objective and subjective law, law and morality, aspiration to acknowledge the actual sense of the supreme law, to approach the decision responding to the ideal demand of (abstract) justice and pragmatic decision, based on the combination of different interests, private and enjoying by the whole society (Harrell, Anderson 1995), the task of civil law is to move in the direction of creating legal rules which would reflect a real development not as the result of a “struggle of interests”, “embodiment of the ruling class will” but by creating the mechanisms allowing for the transformation of the actual civil society will into the legal order.

5. The conflict between private and public interest envisaged by the Russian

society can be seen in the tendency of the State to regulate relations with organizational and financial provisions of capital repairs work to the common property of citizens in the housing legislation.

It should be noted that not by chance we have chosen the housing sphere, because here, as well as in health and social security services, the slow retirement of the State is, as a result, shifting the burden of responsibility upon population (Gontmakher 2015).

By way of conclusion, according to all the connections made above, the existence of the “vector approach”, which would point to the right direction of the State interest, has not been discovered yet. Besides, isolated and unmethodical rules don’t have the unified direction and shift the burden of the property responsibility on the private subjects and form the new pattern of strip of possessions from the population through accumulating money at the accounts of the State asset turnover subjects affiliated with state officials.

The legislator does not settle the problem at all and does not even create the “vector” leading to the development of the system as a whole, being urgent the problem of maintaining and renovating the housing fund cannot be settled only by legal means (Pavlov, Batova, Kovalyova, Kolesnikov, Sokolov, Soboleva 2016). The elaboration of new materials, the development of technologies and real estate reconstruction technologies is the universal panacea of settling the high-priority Russian problem.

Nevertheless, law in any form is capable to adequately influence materials effectively employed, technologies and actions throughout evolution of the State. Rapidity and efficiency of the performance of obligations arisen under civil law to carry out a total building renovation depend on the accuracy, consistency and comprehensibility of such legal orders. Since the law provides for the rights - recognized upon public organs - to establish all the necessary conditions for the realization of the constitutional right to housing - granted to citizens - and to develop those provisions in the area of property rights, legal clearness is desperately needed

(Goncharov, Inshakova, Kazachenok, Dikarev 2016).

It should be noted that the legal mechanism allowing for the realization of duties and obligations of property owners in the apartment buildings, when choosing the way of forming capital repair of the common property funds in their house, is utterly incomplete. Hence, the need for its long-awaited improvement, which could be promoted, to a large extent, by information and communication technologies (Shugurov, Shugurova, 2015). Embodied in the legal *corpus*, these provisions testify to the fact that that too little attention is paid to such elements of relations connected with housing as information and the process of communication of ideas between their participants.

Indeed, information support is inextricably linked with the realization of economic and political power in the content of the legal relation, object (the dwelling place): economic power as the combination of economic, social and other prerogatives and obligations; political power as the system of prerogatives of federal, regional and municipal bodies of power. On the other hand, information support is closely connected with structuring the vector direction of the State interest in the sphere of housing realization. This vector direction entirely covers the above-mentioned legal links, namely, constitutional, administrative and legal content. Actual elaboration and acceptance of the vector direction in the realization of the State interest in the housing sphere would allow to trigger positive effects and, consequently, accelerate and legitimate processes and procedures exercising of mutual rights and obligations of the subjects involved.

6. In the economic life of society State and private interests are realized. For the time being, there is no integrated theory on how law should reflect the interests of these subjects. The analysis of the current situation of the Russian civil law allows to conclude that the vector of the civil law development has been plot neither on a theoretical nor on a concrete level.

According to the Authors, the vector direction should be plot in the realization of public, social, State interests while private ones could be realized in with non-systematic means. Yet, in practice the reverse situation arises: public interest is realized without the vector direction, and its realization is strictly regulated. It determines a shift in the balance of regulation and an escalation of the social tension. The true cause of such a situation lies in the fact that the degree of interconnection between the State and civil society is inadequate and, consequently, the State is incapable of successfully converting true public interests into legal rules.

As a private conclusion comment we should acknowledge that incompleteness of the legal mechanism providing for the realization of the way of forming capital repair of common property fund chosen by the property owners in apartment buildings by means of accumulating financial assets in their special account.

The provisions of the housing legislation examined in the article are not in conformity with the interests of society - and, therefore, with the State's - because they aim at protecting interests of the particular participants of legal civil relations to the detriment of society as a whole.

References

1.AKSENOVA (2007) «Public and private in Roman law: the axiological aspect: extended extract», *Candidate thesis, Kazan State University.*

2.BABAKOV (2015) «The Concept of the State Involvement in Civil Legal Relations in Terms of Civil Law Methodology Components», *Bulletin of Perm University*, 3: 71-76.

3.BATOVA, BELOUSOV (2014) «Ensuring the Economic Security of the Russian Federation as one of the Tools for Implementing State Functions», *Life Science Journal*, 11-6: 432-435.

4.BELOUSOV., PAVLOV, BATOVA, KOLESNIKOV, VYUSHKINA (2016) «Evolutionary-genetics Regularities of the Origins of Economic and Legal Systems Imbalance at the Regional Level», *International journal of advanced and applied sciences*. 3-5: 16-20.

5.DERNBURG (1906) *Pandecta. Volume I. General part* (Moscow: University printing office).

6.GONCHAROV, INSHAKOVA, KAZACHENOK, DIKAREV (2016) «Unfair “Housing Regulation of Major Construction” in the Russian Federation», *International Journal of Environmental & Science Education*. 11-7: 9741-9752.

7.GONTMAKHER (2015) «Health and Welfare: in Search of Balance of Interests», *Journal of the new economic association*. 2: 259-264.

8.HARRELL, ANDERSON (1995) *Equal Justice Based on Law. The Supreme court in the American life*. (Moscow: Manuscript).

9.INSHAKOVA, GONCHAROV, SEVOSTYANOV (2017) «Institutional Ambiguity of Regulation of Possessory Relations in Modern Russia», *Overcoming Uncertainty of Institutional Environment as a Tool of Global Crisis Management*. 1: 207-212.

10.MAKOVSKY (1994) «Concept of the Civil Code of Russia». In: *Civil legislation of the Russian Federation: status, problems, prospects. The concept of civil legislation of the Russian Federation: Abstracts of the international scientific and practical conference* (Moscow: Publishing house of the Institute of law and comparative law).

11.MALTSEV (2004) «Ratio of Private and Public law: Problems of theory». In*: Civil and trade law of foreign countries: textbook / Under the editorship of V.V. Bezbakh, V.K. Luchinskyi.* (Moscow: MCFER).

12.MARX, ENGELS (1961) *Complete works. Vol. 25-I* (Moscow: Publishing house of political literature).

13.MEDVEDEV (2015) «Forward, Russia!» URL: http://www.kremlin.ru/news/5413 (date accessed 10.03.2018).

14.OSIPOV (2016) «Legal Awareness: Notion and Structure», *Legal science and practice-bulletin of Nizhniy Novgorod academy of the ministry of the interior of Russia*, 1: 305-309.

15.PAKHMAN (1882) *About the Modern Movement in the Science of Law: Speech delivered at the annual meeting of the law society, held in St-Petersburg University on February 14, 1882*. (Saint Petersburg: Printing Office Of The Governing Senate).

16.PAVLOV, BATOVA, KOVALYOVA, KOLESNIKOV, SOKOLOV, SOBOLEVA (2016) «Problems of State Regulation of Innovation Policy in the Russian Federation and

Foreign Countries», *International journal of advanced and applied sciences,* 3-4: 25-32.

17.PORAT (2006) «The Dual Model of Balancing: A Model for the Proper Scope of Balancing in Constitutional Law», *Cardozo Law Review*, 27-3: 1393-1448.

18.RYZHENKOV (2017) «The nature of civil law regulation: theoretical and philosophical analysis», *Modern law*, 8: 35-39.

19.SENYAKIN (2007) *Federalism as a Principle of the Russian Law*. (Saratov: Saratov State Academy of Law).

20.SHARAEVA (2015) «The Balance of Interests at the Institute of Reconciliation», *Legal science and practice-bulletin of Nizhniy Novgorod academy of the ministry of the interior of Russia,* 29-1: 366-369.

21.SHAYO (2010) «Public Interest and Seizure of Property». In: *Constitutionally legal bases of property and entrepreneurship: problems of realization: Collection of reports*. (Moscow: Institute of law and public policy).

22.SHERSHENEVICH (1910) *General Theory of Law.* (Moscow: publication of Bashmakov brothers).

23.SHUGUROV, SHUGUROVA (2015) «International Technology Transfer: Controversial Global Policy Issues», *Environmental Policy and Law*, 45: 133-139.

24.SYRYKH (2007) *Logical Foundations of the General Theory of Law: In 3 volumes. Volume 3 "Modern Understanding of Law"*. (Moscow: RAP).

25.VAVILIN (2017) «The Public Interest in Civil Law». In: *Perm Seventh Congress of legal scholars (Perm, November 18-19, 2016): Collection of scientific articles* (Moscow: Statute).

26.YASER (2005) «Civil Protection Against Abuse in the Law of Russia and Yemen», *Candidate thesis, Kazan State University.*

27.YATSENKO (2016) *Civil-law Protection of the Public Interest: Monograph / Under the editorship of V.S. Em*. (Moscow: Statute).

28.ZHALINSKY, ROERICHT (2001) *Introduction to German law*. (Moscow: Spark).