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# Examining agency governance in the European Union financial sector – a case-study of the European Securities and Markets Authority

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## ABSTRACT

Ever since the outset of the financial crisis of 2009, agencies have emerged as key actors of European Union (EU) financial sector governance. As an organisational form that can be insulated from national political pressures, and committed to the Union interest, agencies proliferated in the financial sector ushering the *agencification* trend in finance. In this sense, the European Securities and Markets Authority (ESMA) – as part of the European Supervisory Authorities – practically embodies this trend. ESMA presents a radical shift in financial markets' governance due to the nature of its *soft law* regulations and the direct impact it exerts on addressees' behaviour in emergency circumstances. But ESMA's success in optimising financial sector governance largely depends on its legitimacy, which is centred on independence. At the same time independence demands wider participation and inclusiveness of the decision-making process. This is not easy to achieve in a complex system with multiple stakeholders as is the governance of the EU financial sector (e.g., EU institutions, national actors, private sector). This paper examines ESMA's interinstitutional relations and independence in light of publicly voiced criticism. We find that ESMA's main executive bodies are still susceptible to influences by Member States as well as EU institutions (i.e., Commission), which undermines its operational independence.

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## 1. Introduction

'Agency governance' emerged as one of the most striking features of post 2009 financial crisis regulatory reforms transforming the European Union (EU) financial sector. The rationale of agencies proliferating within the financial sector complements that of the broader institutional phenomenon of *agencification* (Egeberg & Trondal, 2016; Groenleer, 2009) of the European political-administrative order. In the context of the financial sector, agencification has significantly transformed the institutional framework of financial supervision at the European level, with the establishment of the European Supervisory Authorities (ESAs) as part of the European System of Financial Supervisors (ESFS). The ESAs comprise

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three Union specific agencies: the European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

The creation of supranational regulators within EU finance comes as a by-product of post-crisis reforms as well as a complementary development to the recent trend of centralisation in EU economic governance (Wyplosz, 2015). In this sense, the ESAs connect the national (decentralised) level with the EU (centralised) level, which is not a novelty in EU arrangements for regulatory governance. In fact, the ESAs build upon the pre-crisis institutional basis whose core was made by the decentralised, network-based, 'Lamfalussy Level 3 committees' (LL3Cs). The LL3Cs were rather diplomatically introduced with the regulatory overhaul in the early 2000s. They were coordinating bodies, which allowed closer cooperation and coordination among National Competent Authorities (NCAs) in regulatory matters with the aim to achieve stabilising convergence between Member States (MS) in the long run. Centralisation of governance at the supranational level (i.e., policy creation, implementation, supervision and sanctioning) was not something MS would have agreed too easily at the time. As noted by Chiu (2008, p. 256): 'One of the concerns regarding the creation of (...) an EU securities regulator, would be the increasing democratic deficit that is felt generally in EU governance'. But, when global turmoil reached its apex and turned into a Eurozone crisis, the many weaknesses of decentralised supervision were exposed. Loose cooperation in regulatory matters was no longer sufficient to safeguard the stability of financial markets. This opened a window of opportunity for centralising regulatory powers on the EU level. In the attempt to stabilise the Economic and Monetary Union (EMU), European policymakers decided to re-vamp the institutional power of the LL3Cs by transforming them into supranational agencies. This move significantly reduced MS capacity in financial policy and gave way to vociferous public criticism of the EU and its increasingly technocratic nature (Andenas & Chiu, 2014; Pastorella, 2016). The scepticism toward 'more Europe' was further fuelled by the fact that ESAs have not been complemented with comprehensive accountability mechanisms. Moreover, the design of voting modalities in their main executive bodies (e.g., supervisory boards) has put into question their independence. Namely, national authorities still retain a strong position in ESAs due to their participation in the board of supervisors (i.e., the main decision-making body). But the strong role of MS proved problematic (as we will elaborate on the case study of ESMA) as 'conflict of interests run risks of permeating the very substance of the authorities' work' (Busuioc, 2013a, p. 121).

Against this background the paper's main research question is whether agency governance – as embodied by the ESAs and ESMA in particular – represents the optimal mode of regulatory governance of European financial markets? In other words, does centralisation of decision-making within Union agencies, guarantee effectiveness of financial sector governance? We argue that agency governance in the financial sector exhibits significant peculiarities when compared to other European policy sectors in which agencification has already proliferated (e.g., telecommunications, food safety, etc.). Namely, the context of EMU's multilevel and multitier governance, seriously challenges the governing potential of agencies, as it won't be easy to strike the balance between heterogeneous interests of various stakeholders in practice. Our main hypothesis is that, although ESAs and ESMA were endowed with unrivalled legal powers further supported by the European Court of Justice (ECJ), within the financial sector they became burdened with significant and restricting 'power struggles' arising from divergent and influential national and Union interests. We

investigate to what extent this type of playground burdens agencies' decision-making processes and undermines its operational effectiveness and independence, as well as raises public scepticism – all crucial for the success and legitimacy of agency governance in the EMU.

It is important to state that this issue is not extensively covered in the literature and, moreover, it is not yet examined in light of Banking/Capital Markets Union reality as well as the recent Brexit vote. This paper examines agency governance in light of both of these developments. Moreover, existing scholarship mainly addresses issues such as: political limits of agencification (Chamon, 2016), ESAs' (quasi) rule making (Busuioc, 2013a) or their organisational set up and functioning (Weissman, 2016). Henceforth, the main scientific objective of this paper is to bridge this research gap. In order to achieve this objective, the paper: (i) embeds agency governance in the European financial sector in the wider literature on agencification; and (ii) ascertains the ambiguities which have emerged as a result of agency governance in the EU financial sector, particularly by examining the issue of agencies' independence (as a prerequisite for governance legitimacy). In order to do this the paper relies on the empirical case study of ESMA, a Union specific agency that – as regulator of EU financial markets – embodies the agencification phenomenon in practice. Besides empirical research, the paper employs qualitative, descriptive analysis of legal documents (ESAs founding acts, ECJ case-law), official texts and policy papers (European Commission, European Parliament, International Monetary Fund, think-tanks) pertinent to the subject. The scientific contribution of this paper is that it:

- (1) Determines the motives behind ESMA's establishment, its organisational set-up and inter-institutional relations.
- (2) Evaluates ESMA's independence, in light of publicly voiced criticisms.
- (3) Contributes to the common understanding of the role that agencies play in EU financial sector governance.

We further substantiate the paper's conceptual framework with empirical analysis of ESMA's deliberations and decision-making.

The paper proceeds as follows: section two gives an overview of the emergence and progress of the agencification phenomenon in the EU financial sector by referencing the most important literature in the field. Section three looks into correlations between financial crises and their influence on the proliferation of agencies as key decision-makers. Section four case studies ESMA and ascertains ambiguities raised by its role in the rule-making process. Lastly, section five concludes.

## 2. Literature review

Progressiveness is one of the more striking features of the EU's governance as well as the trend of 'regulatory institutionalisation' (Levi-Faur, 2010, p. 24). This multifaceted trend refers to the growing number of EU agencies that have re-weighted the institutional balance in the EU, by delegating policy activities outside traditional departments of EU public administration. Namely, tasks that have previously belonged to Member States or to main political institutions, such as the European Commission and the Council, are now being delegated to a set of agencies meant to operate independently (Busuioc, 2009, p. 14; Busuioc, Groenleer, & Trondal, 2012). This is not a surprising feature of EU governance as conceptually it complements the idea of 'de-politization of the common market' (Majone,

1996, p. 330) in line with the Union's non-political character and the EU principle of subsidiarity (Hofmann, 2010, p. 310). The increased creation of agencies raised a number of issues regarding the technocratisation of EU governance, related primarily to the legitimacy, independence and accountability. Reluctant to give up on more parts of their sovereignty, Member States are eager to secure leverage within agencies (Busuioc, 2013b, p. 30).

In this respect, the financial and sovereign debt crisis have ushered an unprecedented era of technocratic governance in the EU (Everson, 2012, p. 1, 6; Busuioc, 2013a, 2013b). The technocratisation phenomenon initiated by the post-crisis policy reforms has been so substantive that it is now completely transforming EU governance in a variety of policy areas, most notably in finance. In this respect not only do ESAs embody new paradigms in regulation and governance, they also mark a new evolutionary step in financial supervision, namely that of agencification (Busuioc, 2013b, p. 15). Levi-Faur (2010, p. 8) describes it as a phenomenon of “formalizing roles and missions in organizations with spatial boundaries and formal identities, either by devolution of functions from the core organization or the creation of new organizations for performing of new functions”. In the words of the same author, ‘agencification founded on the establishment of agencies as administrative organisations with distinct, formal identities and functional capacity, serves as the Commission’s main tool in consolidating governance’ (Levi-Faur, 2010, p. 6) in different areas of integration, monetary union included. In the wake of the financial crisis this feature of EU governance manifested at the lower level through the establishment of Union specific agencies. The set up of the ESAs as a practical embodiment of post-crisis conceptual reforms has only increased the scholarly interest in the agencification phenomenon, directing the analytical limelight on its development within finance. With ESAs we are witnessing a ‘qualitative increase in agencification’ due to the broader powers formally granted to agencies (Busuioc, 2013b, p. 15). The extent of this phenomenon goes so far that it increasingly defines and shapes the future of financial integration. Together, regulatory reform and agencies form the backbone of new governance orthodoxy in the EMU, which follows the premise that independent agencies will improve regulatory performance and efficiency without the externalities of ‘democratic deficit’ often associated with EMU’s governance (Busuioc et al., 2012; Pollitt, Talbot, Caufield, & Smullen, 2004; Self, 2000).

In support to these theoretical and institutional developments, an abundant literature has emerged on the subject of agencies and agencification. All of these contributions identify and discuss the ambiguous impact that agencies exert on the regulation and supervision of integrated financial markets. At this point it is important to consider what ESAs establishment represents in the context of the broader agencification phenomenon. It is also appropriate to ‘set the stage’ for our ensuing case study. We do both of these things by interrelating the literature discussing core terms pertinent to the subject at hand: the regulatory state, agency (or ‘regulatory agency’ more specifically) and agencification.

The post-crisis environment is characterised by the rise of the ‘regulatory state’, at least in the context of the EU. In this respect Jordana and Levi-Faur (2004, p. 8) note that among a large number of candidates for a label that captures the essence of recent changes in the governance of capitalist economy, the concept of regulatory state is especially convincing. Christensen and Laegreid (2005, p. 8) describe the concept of the ‘regulatory state’ as the ‘ever-increasing public intervention in diverse societal spheres where the regulatory state – by means of regulation as the favoured policy tool – corrects negative externalities, promotes competition and protects consumers and citizens’. This description easily translates

to the context of recent developments in EU financial regulation and can furthermore be complemented by Majone's (1997, p. 141 and 143) observations that the regulatory state is more interested in market regulation than in the market's function of assets' distribution or stabilisation. In this regard the regulation promulgated by the regulatory state is predominantly more formal, with privatisation as a characteristic feature (Levi-Faur & Gilad, 2004, p. 23). Henceforth, regulation increasingly involves a shift toward indirect governance, where policy-making powers are delegated to independent bodies who make their decisions based on professional expertise (Christensen & Laegreid, 2005, p. 8).

And while the true nature of the regulatory state is elusive, Moran (2002, p. 412) has little doubt that steering and regulation of the government lay at its core. These can be carried out through a variety of entities, such as traditional government bodies (e.g., parliament, ministries, etc.), national authorities, or finally – agencies.

In practice, it is not easy to make clear differentiations between various types of agencies, as they often perform several policy roles. A straightforward differentiation derives from the nature of their functions: managerial tasks, consultations, or the setting of regulatory standards and their enforcement. So agencies whose primary functions are rule setting and enforcement may be defined as regulatory agencies (Busuioc, 2013b, pp. 22–24). These agencies typically involve experts in their policy-making process, which makes them a favoured governance instrument as they can 'ring-fence' regulatory processes from political pressures as well as open regulatory activities to interested stakeholders (Bouckaert & Peters, 2004).

In this respect, the ESAs – as Union agencies represent an important turn in the context of the wider agencification phenomenon, not only in terms of their powers but also because of the 'heavier emphasis in their founding regulations on their independence' (Busuioc, 2013b, p. 16). The ESAs involve experts in their work and thus support public perception of a more qualified and *unbiased* policy creation process (Gilardi, 2004; Bouckaert & Peters, 2004). This is immensely relevant if we keep in mind that ESAs have considerable (*quasi*) rule-making powers, which present 'the real potential for centralization' (Moloney, 2011 as cited in Busuioc, 2013a, p. 113). What is even more significant is that the European Parliament (2010) noted that these powers will likely increase with time (and the recent establishment of the Banking Union, with its specific set of decision-making agencies confirms this). In light of their powers, agencies' independence becomes imperative, but their current design exhibits specific weaknesses in this respect, as they exacerbate differentiation tensions between MS (Ferran, 2014, p. 32). Their decision-making is subject to a 'variable geometry' as both Eurozone and non-Eurozone MS participate in executive bodies (House of Lords, 2012). In this sense there is a concrete possibility that it won't be easy to strike the right balance between heterogeneous MS preferences, which vouches ESAs legitimacy (*based on independence*) in decision-making *in ultima linea*. As Eurozone MS continue on the path of an ever closer financial integration with the establishment of the Banking Union, they will also achieve greater regulatory convergence than those MS outside the Eurozone. Having this in mind we argue that it will be very difficult for ESAs' to fulfil their primary role of 'functional equivalence' between MS (Ferran, 2014, p. 40) and centralisation without compromising independence or supervisory efficiency, as we'll demonstrate on ESMAs example.



### 3. Financial crises, regulatory reforms and 'technocratic governance'

Reinhart and Rogoff (2009) go back centuries in their historical analysis to show that financial crises have been around 'forever'. Approximately 'once in a century' financial crises lead to a great recession and it seems like, no matter what we do, financial crises will always reappear. The public sector's instruments to fight or prevent financial crises include, among others, regulation and supervision. Phases of regulation and deregulation alternate regularly and are correlated with rises and falls of regulatory agencies and negatively correlated with the business cycles (Banner, 1997; Coffee, 2012).

Following the 2007 financial crisis, the US passed the Dodd-Frank Act (Wall Street Reform and Consumer Protection Act) in 2010, a single regulation with an aim to unchain the 'too big to fail' problem, protect consumers and maintain stability of the financial system (Coffee, 2012, pp. 334–367). The EU opted for a set of legislation. Actually, it seems like the new financial regulatory reform induced by the financial crisis came at the 'wrong time'. The EU had just finished a huge regulatory reform – Financial Services Action Plan (FSAP) from 1999 to 2005 and was taking some time 'off' of regulation (European Commission, 2005, pp. 9–11). Just when the new financial regulatory framework was starting to collect its first impact assessments, in which almost all parties in the securities markets agreed they were overloaded and exhausted (CESR, 2009; CRA International, 2009), the US financial crisis spilled over to Europe and the rest of the world.

As many times commented, 'it's a shame to waista a good crisis' (Coffee, 2012, p. 301; Lannoo, 2009) the financial crisis 2007 marked a new momentum for changes and some old ideas to be materialised. Initiated by substantive regulatory reforms technocratisation is transforming the manner in which policies and decision are adopted and crisis situations managed within the European financial sector. This increasing reliance on expert governance and Union *agencies* comes both as a pragmatic answer to the functional imperative of deeper financial integration and a normative necessity (Everson, 2012, p. 6). From a regulatory perspective the ESAs constitute a culmination of agency rule-making powers (Busuioc, 2013a, 2013b) and a radical shift in the way 'banks, stock markets and insurance companies are policed as of 2011' (European Parliament 2010). Will this regulatory and supervisory set up safeguard us from another major financial crisis? Agency governance is of highest importance for macroeconomic strength because it represents the basis for stability and growth and fortification against future crisis. This also implies that regulatory agencies must often go against the tide and make unpopular decisions, situations in which their independence and accountability represent their biggest assets. Moreover, independence and accountability are at the core of agencies' legitimacy. As put by Bini-Smaghi (2006, March 9): 'An independent authority that has no accountability may develop into an autocratic Leviathan. An authority without independence runs the risk of being prisoner of interest groups'. As we have noted previously both ESAs' institutional design as well as decision-making modalities challenge their independence. One of the problems is that national actors are strongly embedded in ESAs' executive bodies. And if we keep in mind 'variable geometry' issues that raise tensions between Eurozone/non-Eurozone MS, conflicts of interests can be expected (at the expense of agencies' legitimacy and efficiency).

Henceforth, in the following section we examine this topic more concretely, focusing on ESMA's capacities and its 'role-model potential' for financial sector governance.

#### 4. ESMA as a regulatory agency: operational set up, policy capacity and independence

ESMA was built upon The Committee of European Securities Regulators (CESR), a coordinating body established in 2001 within 'Lamfalussy's Procedure' with a goal to endorse operational effectiveness of the FSAP regulatory reform (Lannoo & Levin, 2004; more in-depth on ESMA's background in Bajakić, 2013). Comprised of senior representatives from National Regulatory Authorities (NRAs), its tasks were consulting the Commission and coordination between Member States to improve cooperation through soft tools such as peer-reviews and best practices (European Commission, 2001, p. 43). CESR issued guidelines, recommendations, non-binding technical standards, created databases and published comparative analyses of Member States praxis, impact assessments, etc. (CESR's Annual Reports, 2006–2010). Despite a small number of staff and a modest budget, CESR proved to be a very efficient and productive body and have contributed to a higher level of transparency and Member States cooperation (Ferran, 2012, pp. 117–125; Fischer-Appelt, 2011, p. 2; Moloney, 2011, pp. 81–83; Wymeersch, 2010, pp. 5–7). However, due to its non-binding nature, certain legal restraints and political obstacles of the Member States, CESR was not able to utilise its potential to the maximum (CESR, 2004, pp. 18–22; European Commission, 2007, pp. 6–13; Securities Expert Group, 2004, p. 17).

ESMA was created as a hard-core European regulatory agency, with legal personality. It acts independently and objectively and is accountable to the European Parliament and the Council (ESMA Regulation, art. 5(1), 1(5(4)), 3). The objectives of ESMA are: improving the functioning and transparency of the internal market through effective regulation and supervision, improving supervisory coordination and preventing regulatory arbitrage and ensuring stability by timely assessing different risks (art. 1(5)).

ESMA's tasks are numerous and include significant new powers (e.g., in emergency situations, the power to adopt individual decisions addressed to a financial market participant or NRAs (art. 18), investigate alleged breach or non-application of the EU law and address it with a recommendation (art. 17), assist or settle disagreements between NRAs in cross-border situations (art. 19), directly supervise the credit rating agencies). On the one hand, revision of ESMA Regulation calls for even more power to be designated to ESMA. The European Commission observed that there is 'some room for targeted possible extensions' (European Commission, 2014, p. 4). This includes areas of: consumer/investor protection (Shareholders Rights and Takeover Bids directives), shadow banking and implementation of International Financial Reporting Standards (IFRS) (European Commission, 2014; The European Parliament, 2014, Annex, point 1).

On the other hand, the most significant and controversial powers have not yet been exercised by ESMA during the first three and half years of its operational existence (breach of the EU law, emergency situations, binding mediations). ESMA has instead made use of non-binding mediation powers and moral suasion (European Commission, 2014, p. 7). A partial explanation is that Board of Supervisors (BoS), composed of heads of NRAs, has been reluctant to make recommendations to NRAs or individual decisions to financial institutions (European Commission, 2014a, p. 12). Other explanations given by stakeholders include 'dissuasive effect of the relevant powers' and haziness of the scope and triggers in the ESMA Regulation (European Commission, 2014a, p. 13).

The governance structure seems to be the weakest link of ESMA's independence. It underlines constant power-struggles between national and supranational level as well as



influence of strong Member States and the European Commission. The Commission's influence, in particular, challenges the sensitive inter-institutional balance in financial sector governance. The independent reports state that even the members of the BoS themselves agreed that national interest were at times prevailing at the expense of overall EU interest (European Commission, 2014a, pp. 12–13; European Parliament, 2014; IMF, 2013, p. 11; para. AU). More specifically, debates and outcomes were influenced significantly by the major NRAs and the European Commission, while some initiatives and actions proposed by the Chairperson were not supported by the BoS (Mazars 2013, p. 34). Different interests of the strong Member States had been present in the regulatory arena, having traditionally the UK on one side and the Franco–German alliance on the other (e.g., Alternative Investment Fund Managers Directive (AIFMD); European Market Infrastructure Regulation (EMIR)); with the UK's position being impaired in the post-crisis regulatory design (Ferran, 2012a). This situation is worrisome as regards to prevention of future crisis. Memorandums of understandings and current cooperation praxis between the NRAs have not yet reached the desirable level of truthful collaboration. This state should urgently change because the Eurozone crisis has further emphasised the need to adequately supervise and control large financial institutions that operate across borders. They represent significant risk not only for the financial system but for the stability of the EU as a whole since the agreement regarding recovery and resolution for failing financial institutions has not been operationally finalised with regard to division of the bailout burden between which Member States' tax payers and other parties involved. In that respect it seems reasonable to further promote independence and power to ESMA for ensuring stronger and more effective cooperation between NRAs.

The relationship with the European Commission is presently similar to the teacher–pupil relation and could possibly be burdensome for ESMA's operational independence. The Commission outlines ESMA's work programme, regulatory priority list, budgetary and administrative process, and consumes most of ESMA's operational time and energy (Mazars 2013, pp. 47–48). Consequently, it's not surprising that 83% of stakeholder perceive ESMA as 'not-independent' in relation to the Commission (Mazars 2013, p. 143). The European Parliament, Annex 2014 raised a concern and need to assess the European Commission's robust influence over ESAs and ways to enhance their autonomy. However, things might change in direction of more secession in the future due to the ECJ ruling regarding the ESA's executive powers (The Case C-270/12, 2012).

Few other factors contributed to the 'so-so' rating, e.g., the peer review operational methodology. Peer reviews' goal is to enhance supervisory convergence, however in practice it went down to NRAs reviewing each other and adopting such reviews instead of conducting independent assessment of their regulatory and supervisory frameworks (Mazars 2013, pp. 100–101). ESMA's work on building common supervisory culture and consistent supervisory practices has been evaluated as limited in impact (Mazars 2013, pp. 96–102). The Securities and Markets Stakeholders Group (SMSG) (European Commission, 2014, p. 10), designed to help facilitate consultations with stakeholders in areas relevant to ESMA's scope of work, seems to have limited impact as well. Beside high operational costs, SMSG's meetings with the BoS were characterised as unproductive, although ESAs and other stakeholders perceive them as an asset and suggest strengthening their role in the future (European Commission, 2014; Mazars 2013, pp. 34–35).

The Board of Appeal (BoA) was established as a counterbalance measure for new sets of powers assigned to ESAs. It's a joint body of all three ESAs comprised of independent professionals to allow the possibility for natural and legal persons to appeal against ESA's

decisions and get feedback in a timely manner (ESMA Regulation, art. 60). This is another old idea brought out of formalin. In 2004 the Securities Expert Group (2004, p. 18) comprised mostly of private sector representatives, suggested establishment of the European ombudsman for market participants, to enable them to complain about NRA's implementation or supervisory decisions that are not in line with the EU legislation. To the time of writing, four appeals have been raised against decisions of EBA and ESMA. One appeal against the decision of the ESMA with regard to credit rating agency (CRA) registration was dismissed and another appeal concerning the alleged breach of the EU law by the Luxembourg NRA was declared inadmissible (ESMA, 2015). The stakeholders found the structure of the BoA satisfactory (European Commission, 2014a, p. 22), however they required more clarity as for the possibility of challenging guidelines and recommendations within the BoA (European Commission, 2014, pp. 5–6).

ESMA's staff shows high levels of operational efficiency and productivity: contributing to the EU single rulebook, more than 90 drafts of technical standards submitted to the Commission, six peer-reviews, guidelines, data analyses, four investor warnings, direct supervisory of 22 CRAs and six trade repositories as off recently, constructive stakeholders dialogue, international relations, etc. (ESMA, Annual Reports 2011–2013; European Commission, 2014, p. 5; Moloney, 2013, p. 960). Over the years, ESMA's number of staff has almost tripled from 56 in 2011 to 153 in 2014 (ESMA, 2014, p. 7), still there seems to be a human resource deficit in comparison to the workload (European Commission, 2014, p. 7). Also, there is a plea for a bigger role and influence of ESMA's staff and its Chairperson (European Commission, 2014, p. 5, pp. 12–13; The European Parliament, 2014, Annex), most likely in order to navigate the course towards more supranational orientation and more independence. Just like CESR, ESMA's administration comprises highly effective experts in their field, which proves to be a contributing factor to both transparency and regulatory integration. However, it remains an open question if positive effects will endure beyond the early stage of ESMA's organisational and institutional development.

Since its establishment, ESMA's budget has almost doubled from €16.96 million in 2011 (ESMA Annual Report 2012, p. 71) to €33.2 million in 2014 (ESMA, 2014a). Presently, it comes from three sources: Member States NRA's budgets (50%), EU budget (35%) and levies on financial market participants (supervisory fees, 15%) (ESMA Annual Report 2012, p. 71). ESMA calls for a budget increase and changes in a structure of budget contributors, in favour of Member States NRAs, due to their budget constrains (ESMA, 2014, pp. 2–3). Increasing EMSA's budget at the expense of NRAs would in practical terms lead to a vicious circle of decreasing supervisory quality at the national level with eventually a negative spill-over effect at the supranational level. The European Parliament is supportive of such a proposal (European Parliament, 2014; para. BI, 3), while the Commission put forward an idea of 'ideally' abolishing EU and NRAs contributions altogether (European Commission, 2014, p. 11). This means that the private sector might have to bear additional costs up to approximately €28 million. However, this might lead to a problem of regulatory capture of ESMA by the regulated party, i.e., the private sector (Stigler, 1971). Then again, ESMA presently seems to be under certain influence of the Member States.

Ferran (2012, pp. 136–137) further emphasised the gap in sizes of the NRA's and ESA's budgets with regards to ESAs (in)ability to exercise given supervisory power. In comparison to €72.9 million, which was the 2013 budget for all three ESAs, NRAs have multiple-sized budgets as well as long-term know-how and experience in direct supervisory activities

(Mazars 2013, p. 53). In practice, ESAs are disabled to supervise implementation of the EU law in the MS (European Parliament, 2014; para. BB). Due to human and financial resources restraints, further expansion of ESMA's direct supervisory powers will most likely be very gradual (Moloney, 2013, pp. 963–965).

The fairly recent ESMA judgment by the ECJ has given ESAs new space for autonomous actions (The Case C-270/12, 2012). The UK challenged the power of ESMA to ban short selling, arguing that ESMA was given wide-ranging discretionary power that were contrary to the EU law and especially the *Meroni* doctrine. The ECJ ruled that powers of ESMA are compliant with the *Meroni* doctrine, i.e., given executive powers were precisely delineated, subject to judicial review and did not grant large measure of discretionary power (The Case C-270/12, 2012, points 45–50).

Some saw the ECJ judgment as a political decision, a big loss for the City's (The City of London (here after: City)) business and a great defeat of UK's longstanding legal arguments to keep under control centralisation of powers at the EU level (Baker, 2014). Others find it a realistic and pragmatic turn of events considering current macroeconomic circumstances:

'At a time of continuing economic crisis, judicial intrusion into a carefully crafted European system designed to control systemic risk within financial markets, would surely have represented a victory of law over common sense, or a judicial disregard for the vital need to ensure continuing financial stability within Europe.' (Everson & Vos, 2014, p. 12)

The new Brexit situation has shaken the European financial markets. The City is Europe's largest and most important financial centre with the top financial infrastructure, the know-how and the business culture, which is hard to 'copy paste' into another continental European city, traditionally marked as bank oriented system. Also, the financial markets and institutions are closely interlinked and interdependent so it makes it hard to foresee to what extent the future relationship will be competitive or cooperative.

The EC's President, Mr Juncker, introduced the Capital Markets Union (CMU) for this Commission's mandate (2014, p. 7). "That will provide benefits to real sector of the economy" – it stands for the sector of the economy that produces goods and services sector by cutting the cost of raising capital and dependence on bank funding (European Commission, 2015). In other words, acknowledging the benefits of the market oriented system. The new European Commission's policy communication (2016) has no mention of the Brexit situation and possible change of course, but instead highlights its determination to further accelerate the CMU reform. Again, two scenarios might occur: this policy might improve EU27 capital markets competitiveness to become the UK's stronger competitor or it might (un)intentionally stir towards more convergence of the two systems making financial markets more integrated in their own goals while bypassing some Brussels politics along the way.

The post-Brexit model most likely won't mean numerous regulatory changes for the UK since the FSAP process bended toward the UK model. The matters of the ECJ rulings are more likely to be discussed at the divorce negotiation table. In April 2014, the UK lost the case at the ECJ concerning securities markets and the tax issues. The UK challenged, more as a precautionary measure, introduction of the Financial Transaction Tax (FTT) by 11 Member States, arguing it will produce additional costs for the non-participating Member States (The Case C-209/13, 2013, point 16). The ECJ has, *inter alia*, found that extra costs for non-participating Member States are impossible to examine before the implementation of the FTT as result of enmeshed cooperation by some Member States (The Case C-209/13, 2013, point 38). The post-Brexit model will take some time to unfold during which the

UK will be a MS for at least another two years following some transitional periods during which some new unexpected macroeconomic circumstances might arise at the European or global level.

## 5. Concluding remarks

In the post-crisis environment, governance of the EU financial sector has largely been characterised by centralisation of decision-making as well as by the proliferation of Union specific agencies in this sector. Agencies are a favourable organisational form that can be 'ring-fenced' from national political pressures, and committed to the common, European objectives (i.e., the Single Market project and financial integration), which is why recently their number has increased in the financial sector. Agency governance is the way forward in re-conceptualising EU's mode of governance in the financial sector, and the main framework for its institutional re-design.

In this respect, the ESAs constitute a culmination in agency powers in the context of financial sector governance. Their establishment presents an indicative trend in the manner the financial sector will be governed in times to come. From a governance perspective, these authorities connect the national (decentralised) level with the supranational (centralised) levels, which is not a novelty in EU regulatory arrangements (e.g., the Lamfalussy network-based Level 3 committees).

In 2010 ESMA was founded on this conceptual and institutional 'blueprint', as a specific Union agency assigned with numerous tasks and with re-vamped policy powers (in comparison to its predecessor, the CESR). Moreover, the revision of ESMA Regulation and signals from the European Commission leave the door open for 'targeted extensions' of such powers in line with furthering financial integration. But ESMA's success in optimising EU financial sector governance largely depends on its legitimacy, based on the agency's independence (as a prerequisite). At the same time independence demands participation and involvement in the decision-making process, which is not easy to achieve in the complex system of financial sector governance where multiple stakeholders have to be observed (e.g., EU institutions, national actors, private sector). Securing independence and legitimacy of ESAs is not only theoretically challenging but has direct implications to the quality of ESAs' decision-making and governance (in terms of decisions' representativeness and legal certainty).

During 2013 the European Parliament's Committee on Economic and Monetary Affairs reviewed the ESAs-led governance system. Judging by ESAs activities and performance, the general opinion of the European Commission and the European Parliament (EP) is that ESAs were efficient in delivering results against a demanding work programme, especially in the area of the Single EU rulebook and supervisory convergence and coordination. The same review identified many areas for improvements, among which enhancing the transparency of the regulatory process and achieving better balance within the stakeholder group, to name a few. But what was more important, the EP's assessment put forward an unexpected indictment; namely from all three supervisory authorities, ESMA was the one that scored the lowest regarding independence. The criticism was primarily directed to ESMA's main executive bodies (i.e., the Management Board and the Board of Supervisors), and more concretely, to NRAs' work therein, which was deemed far too 'national' in order to represent the 'interests of the Union' (Andenas & Deipenbrock, 2016). The truth is that it is not easy to strike the right balance between Member States' heterogeneous interests

and that of the Union as a whole in agencies' decision-making, and this has proved to be problematic for ESMA's independence. At the same time, independence is immensely important in the context of ESMA's (and ESAs) legitimation as key stakeholders in financial sector governance. In the aftermath of the sovereign-debt crisis, when projects such as the Banking Union exacerbated differentiation tensions between Eurozone and non-Eurozone MS, ESAs' independence consolidates democratic credentials of financial sector governance. However, in this paper we have demonstrated that the governance framework is the weakest link of ESMA's independence, with its Board of Supervisors often criticised for favouring national interests and for regulatory capture. In addition, its decision-making structure and provisions governing the relationship with EU and MS interlocutors were deemed problematic. In particular the relationship with the Commission has to be redefined and become less burdensome for ESMA's operational independence.

The fact that its independence is still a work in progress presents one of the main obstacles for ESMA to fulfil its role-model potential with respect to regulatory governance in the financial sector. In this sense it is crucial that the Board of Supervisors is re-directed away from the national interests and more towards EU interests, while the budget financing structure needs to be carefully crafted in order to evade capture traps. In this perspective, a promising sign of ESMA acting more independently in the future comes in the form of recent ECJ judgments regarding ESAs executive powers. For the time being, ESMA is still perceived as a toddler in the eyes of the grown-up EU institutions and other stakeholders. But kids grow up so fast.

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