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Regulatory Convergence in EU Securities Regulation

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Foreword: The EU, Convergence and Securities Regulation

*Professor Mads Andenas**

1. Dr Iris H.-Y. Chiu has written an important book. The title, *Regulatory Convergence in EU Securities Regulation*, identifies an important legal mechanism in an important field. Dr Chiu's book offers new perspectives on policy and theory. 'Regulatory convergence' is a new technical legal concept in EU financial services and markets regulation. Financial services and markets regulation in the EU was for a long time subject to minimum harmonization. It has been an area of shared competence between the EU and Member States. There is little existing literature dealing with 'regulatory convergence' as a new approach in EU securities regulation. Dr Chiu examines the concept of 'regulatory convergence', how it has been developed and how it is intended to be carried out. She applies theoretical models of analysis and policy reasoning to evaluate the process and prospects of 'regulatory convergence'. Her conclusions are constructive and support the calls for a regulatory agency at the EU level. It is increasingly difficult to understand the case for maintaining national regulators and national regulation with a weak system for 'convergence' at the EU level. National regulation and regulators are no longer effective, and they certainly create many barriers to the functioning of a European market. The approach taken in Dr Chiu's book is unique, and will receive much practical, as well as, scholarly attention. It makes a valuable contribution to current research both in the field of securities regulation and the field of EU governance and the general field of harmonization.

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2. Harmonization is an important feature of the modern legal system. Harmonization of the laws of the Member States is a core instrument of the European Union. In a wider context, many international treaty obligations entail duties to adopt conform legislation and ensure conform application. International and regional human rights treaties provide important examples of this. Another example is in the WTO which has an increasing impact on regulatory standards and also on the institutional side. There is considerable scholarly literature on different harmonization issues, but it is still in an early phase. More scholarship is required in the different fields. Next stage is bringing together the outcome of this scholarship in a comparative analysis or in developing more general theory on the harmonization process or different aspects of it. Moving freely over the boundaries that divide the law and the fragmented scholarly disciplines may usefully combine perspectives in interdisciplinary and multidisciplinary scholarship. In this way, one may provide models for, and improve, the understanding of the harmonization process.

The procedures for adopting the harmonizing instrument, and for subsequent amendments to it, are under rapid development. In the EU, the legislative procedures are a central constitutional concern, and are subject to continuous reform. Different treaty regimes offer new and alternative mechanisms. EU securities regulation is a particularly fruitful area of study in this respect with its sophisticated committee structures.

The form of the harmonizing instrument offers much variety and innovation. International treaties and conventions do not follow universal models. In the EU, there is an important difference between directives and regulations, but also the regulation, which has direct effect without any legislative transposition, often requires different implementation measures to have its effect in national law. Some main types of directives are minimum standards directives, maximum standard directives, framework directives, and directives in the process of open method of coordination. The relationship to the fundamental freedoms in the EC Treaty is another issue. For international treaties and conventions, there is the relationship to customary international law and other treaties and conventions. Here securities regulation offers much innovation with its focus on different levels of harmonizing instruments, and the extensive use of regulations and different levels of directives.

Informal harmonization processes, outside the intergovernmental fora, are of increasing importance. Securities regulation again offers interesting models. The role of model codes, principles and other outcomes of such processes is another field of study. Their interaction with the intergovernmental organs and their reception in contract practice or directly by national legislators or courts merits further attention. Important examples in the sphere of private and commercial law are: *Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Interim Outline Edition.* (2008), the research carried out by the Study Group on a European Civil Code (the von Bar Group) and the Research Group on EC Private Law (Acquis Group) and other academic and scholarly projects and their relationship with more formal EU procedures, see for instance the European Commission's 2003 *Action Plan on a More Coherent European Contract Law*, merit study. The relationship between the mainly

regulatory EU securities law programme and private and commercial law is another area of study.

Transposition in national law takes different form in national legislation, and the procedures vary as well. Harmonization has affected the form of national legislation and the sources of law in the national legal system. Court practice in the application of harmonized law follows yet other principles and patterns. The response in case law to the new sources of law that can assist in promoting uniformity, or in some field, the ways in which the lack of such sources are compensated for, is of particular interest. The use of regulation and judgments from other international or national jurisdictions is one current issue. Informal networks of regulators and judges cooperate across jurisdictional boundaries in the application of international instruments, assisting one another in finding sources and practical solutions to the uniformity problems. The implementation regimes of EU securities regulation provide an important model that repays study. The special procedures for adoption of EU directives and regulations under the Lamfalussy system are complemented by a committee system and review procedure for transposition and implementation.

Amendment and monitoring of the transposition and subsequent practice under national law is another area where there are highly developed regimes in some areas, and in others, practically nothing following the adoption of a convention. There are models involving an independent international monitoring body, or more judicialized institutions, or combinations of supranational monitoring and court institutions. Novel forms of institutionalized peer review have developed over the last couple of decades. The complex model of the Lamfalussy system will here contribute to the empirical and normative material.

Enforcement and sanctioning provide yet other challenges, closely related to monitoring and amendment. This is an area where EU law has particular challenges ahead as this has traditionally been left to Member States (and even held to fall outside the legal mandate provided by the treaties).

The experiences with harmonized regimes provide extensive material which is well suited for research. In the EU, there is an emerging scholarship comparing the transposition of directives in different national laws. Here there is not much scholarship on EU securities regulation. There is, however, a growing body of different reviews undertaken by EU institutions. The European Parliament adds its voice here, not unrelated to the special procedures for adoption of EU directives and regulations under the Lamfalussy system, raising concerns about a reduced role for the European Parliament in the legislative process. The different official assessments and reviews provide a rich source material and also the basis for comparison with other fields. The experiences with a harmonized regime provide a basis for the Review of the Consumer Acquis, which is another of the harmonization projects of the European Commission, currently limited to eight directives, including the Consumer Sales Directive and the Unfair Terms Directive, leaving aside other directives in the consumer field, such as the Consumer Credit Directive, the Unfair Commercial Practices Directive and the Product Liability Directive. Maximum harmonization and the use of mandatory rules in the directives may have had a

profound effect on the private law of the Member States, which, if it has had such an effect, remains underexplored.

In comparative law there is a current discourse about legal transplants. There is also a challenge to the idea of convergence between national legal systems and traditions. One issue here is to link the theoretical models that have emerged here with the scholarship on harmonization in different fields. Here again we find that there are important insights to draw on from the field of EU securities regulation. As many regulatory fields, it is in a state of very rapid development. The idea of a central role for national traditions and variety is not particularly supported and the extensive borrowing between systems is an important feature. Transplants may work, even in the face of fierce resistance from national systems, regulators and industries that have something to gain from maintaining the national alternative.

3. The 2000 Report of the Wise Men on the Regulation of the European Securities Markets, the original Lamfalussy Report, found that the Internal Market had not worked for securities markets.

Home country control and minimum standards have not achieved their goals. National authorities and national systems diverged too much for market integration to obtain. The new system that the report proposed was still based on national law and national regulators.

The Wise Men turned its proposal into an ultimatum: either it achieves market integration or a completely new model had to be chosen. This would then require a European jurisdiction and a European market authority. I have argued for the inevitability of a European solution. Regulation and regulators should follow markets, not impede them or divide them up where this does not serve any central policy purpose.[1] Dr Chiu's study provides powerful support for this argument and the progression to a new institutional model with an EU agency.

4. Dr Chiu's book provides a succinct discussion on the development of EU securities regulation, and discusses the new generation of directives and regulations in EU securities regulation. The book focuses on the specific issue of regulatory convergence, and the discussion of substantive law is wrapped around the focus. This allows Dr Chiu to develop her central thesis.

Regulatory convergence has two aspects: the regulatory and convergence. The book suggests that the regulatory aspect may be looked at in four parts. These are: the source of regulation, the administration of regulation, the supervision of regulation and the enforcement of the regulation. A cybernetic model of analysis is then applied to discuss each aspect of regulation, and the methodology used in securing convergence. The rationale for choosing a cybernetic model of analysis is well explained in the book. The application of this cybernetic model of analysis to the four aspects of regulatory convergence has allowed the drawing of some conclusions about the prospects of regulatory convergence.

The book brings the discussion to a higher level, examining whether there is an EU level regulatory system for EU securities regulation. The final chapters of the

1. M. Andenas & Y. Avgerinos, *Financial Markets in Europe: Towards a Single Regulator* (Kluwer Law International: The Hague, 2003).

book explore theoretical frameworks and EU governance policies to examine if an EU level regulatory system is needed for regulatory convergence to take place. Dr Chiu argues that the Lamfalussy procedure is not sufficiently institutionalized, and CESR's governance is arguably too weak to constitute a 'regulatory system' at the moment. The framework for law-making in EU securities regulation is cybernetically (she sets out clearly what this implies) insufficient to ensure convergence in the sources of law. This will still result in divergences in the content of substantive law applicable across EU Member States. The forces for divergence are significant, and coupled with a weak framework for regulatory convergence, the development of regulatory convergence is rather uncertain. Dr Chiu argues in support for the institutionalization of regulatory convergence, and in favour of an EU agency. She also discusses 'agencification' of the CESR.

5. Dr Chiu's book is unique in its focus on regulatory convergence in EU securities regulation. There are several important contributions made to the wider field of substantive EU securities regulation, notably and comprehensively N. Moloney, *EC Securities Regulation* (Oxford University Press, 2003). E.J. Swan, *Market Abuse Regulation* (Richmond Law and Tax, 2006) is on substantive law and the application of the Directive in the UK. E. Avgouleas, *The Mechanics and Regulation of Market Abuse* (Oxford University Press, 2005) deals with the theory and substantive law of the Market Abuse Directive as well as its application to the UK. These books have a different focus from Dr Chiu's because they explain one area of the substantive laws in detail. Dr Chiu's book builds on this scholarship and adds a valuable discussion on many more aspects of substantive securities regulation, in particular, with a focus on the development of regulatory convergence in EU securities regulation.

Two other books in the field that deserve mention are Eilis Ferran's *Building an EU Securities Market* (Cambridge University Press, 2004) and Manning Gilbert Warren III's *EU Securities Regulation* (Kluwer Law International, 2003). Ferran's title focuses on whether an integrated EU securities market may be built up and how. The book deals with the enactment of new Directives as a means of building up an EU securities market, and the author's critical assessment as to whether that can be achieved. The book appeared in a rather early stage of the Lamfalussy Directives and subsequent developments in regulatory convergence could not be taken account of. Ferran's book focuses on how an integrated *market* may be achieved, whereas Dr Chiu's book builds upon Ferran's thesis that there may be a connection between legal integration and market integration, and goes on to examine how such legal integration is progressing, under the banner of regulatory convergence.

Warren's book examines EU legal harmonization in securities regulation. He also deals with substantive law in half of the book, but the first half of the book is predominantly theoretical. Warren analyzes the forces behind the harmonization of EU securities regulation, and provides a vision of how such legal integration can occur. As the book was written before any of the new Directives were enacted, the book is probably outdated, except for the useful discussions on the background and theory surrounding legal integration.

Dr Chiu's book also adds to, and makes use of, the scholarship of L. Panourgias, *Banking Regulation and World Trade Law. GATS, EU and Prudential Institution Building* (Hart Publishing, 2006), M. Ortino, *E Commerce in Financial Services* (Oxford: Hart Publishing, 2007), and Y. Avgerinos, *Regulating and Supervising Investment Services in the European Union* (London: Palgrave MacMillan, 2003). These three books provide different perspectives on the regulatory structure and support the conclusion that a new regulatory model is now required.

6. Dr Chiu's book is very timely.

We are approaching the mid-cycle of EU securities regulation reforms which began in 2001. EU securities regulation reforms resulted in four new Directives which were completed by April 2005. Early literature on EU securities regulation captured some of the reforms, but not completely so. Further, earlier literature did not discuss in detail the governance provided by the Committee of European Securities Regulators (CESR), whose innovative methods are being discussed by Dr Chiu in great detail in this book. Although regulatory convergence is much used and perhaps reached the status of a policy buzzword in many official EU institutional documents, there is no dedicated study of it, and certainly not to its application in securities regulation.

Dr Chiu's conclusions on the future regulatory structure are not the least important of the contributions of her book. A European regulator will continue to meet with much resistance. First, one has the national regulators who fight for their jobs. Then, national politicians believe that this is a matter of national autonomy, and the industry will rather take the cost of the ineffective national regulation than the risk of the unknown. Finally, even European institutions may resist such changes in their established positions. So it may take a financial crisis of some considerable dimensions to facilitate change. In the meantime, it is for scholarship to prepare the ground and consider which form the reform should take. Dr Chiu's book makes an important contribution, also in this respect.

List of Abbreviations

CESR	Committee of European Securities Regulators
EC	European Communities
ECB	European Central Bank
ECHR	European Convention on Human Rights
ESCB	European System of Central Banks
EU	European Union
FSA	Financial Services Authority
FSAP	Financial Services Action Plan
IDD	Insider Dealing Directive
IOSCO	International Organization of Securities Commissions
ISD	Investment Services Directive
MiFID	Markets in Financial Instruments Directive
MTF	Multi-lateral Trading Facility
OAM	Officially Appointed Mechanism
Regulation FD	Regulation Fair Disclosure
SEC	Securities Exchange Commission

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Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing OJ 1980 L100/1, 4.
Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing OJ 1982 L48/26, 4.
Consolidated Council Directive of 20 December 1985, on the coordination of laws, regulations and administrative provisions relating to undertakings in collective investment in transferable securities 85/611/EEC (UCITS Directive), 21.
Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public OJ 1989 L124/8, 5.
Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing OJ 1989 L334/30, 43.

Council Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies (text with EEA relevance) OJ 2005 L310/1, 4.

Commission Regulation (EC) No. 108/2006 of 11 January 2006 amending Regulation (EC) No. 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standards OJ 2006 L24/1, 22.

Commission Regulation (EC) No. 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive OJ 2006 L241/1, 36.

Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive OJ 2006 L241/26, 148.

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Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts – Protocol annexed to the Treaty of the European Community – Protocol on the application of the principles of subsidiarity and proportionality OJ 1997 C340/10, 98, 153.

Treaty establishing the European Community (Amsterdam consolidated version) Preamble EC Treaty (Maastricht consolidated version) EEC Treaty, OJ 1997 C340/179.

Treaty establishing the European Community (Nice consolidated version), OJ 2002 C325/173.

Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, OJ 2007/C 306/01.