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Changes to the European financial supervisory agencies' soft law powers: legitimacy problems solved or new puzzles created?

Rijsbergen, M.P.M. van; Rogge, E.

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**CHANGES TO THE EUROPEAN FINANCIAL
SUPERVISORY AGENCIES' SOFT LAW POWERS:
LEGITIMACY PROBLEMS SOLVED OR NEW PUZZLES CREATED?**

Marloes van Rijsbergen*  and Ebbe Rogge† 

Important changes to the legislative framework of the three European Supervisory Authorities (ESAs) – the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), and the European Insurance and Occupational Pensions Authority (EIOPA) – have recently taken effect. The ESA review, which is regarded as an important step to ensure a fully functioning Capital Markets Union and Banking Union, reinforces the role and powers of the ESAs. This article focuses on the most significant changes which apply from 1 January 2020 with an impact on the legitimacy of the ESAs' soft law powers. These changes include the introduction of 'no-action letters', modifications to the ESAs' non-binding opinions and Q&As, and a possibility for market participants to address possible ultra vires problems at the European Commission. Altogether, the ESA review addresses several previous legitimacy issues, but at the same time brings to light new legitimacy concerns.

Keywords: European Supervisory Authorities (ESAs); ESA review; soft law; legitimacy; institutional balance; no-action letters

* Senior Policy Advisor at the Dutch Authority for the Financial Markets.

† Assistant Professor at the Hazelhoff Centre for Financial Law at Leiden University and Senior Policy Advisor at the Dutch Authority for the Financial Markets. The opinions expressed are solely those of the authors and in no way represent those of the Dutch Authority for the Financial Markets. The authors are grateful for comments on an earlier version from Lara Ohnesorge, Mira Scholten, Jouke Tegelaar, the anonymous reviewers, and the editors.

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I. INTRODUCTION

Over the last thirty-odd years, the European Union (EU) has seen a gradual increase in EU regulatory agencies as part of its administration.¹ The scope of delegation to these agencies has grown not only quantitatively, but also in qualitative terms: more and more soft rule-making powers are being delegated to EU agencies in an increasing number of policy areas.² These decentralised bodies are distinct from the EU institutions themselves and established with a mandate to accomplish specific tasks. Examples of such agencies include the European Medicine Agency (EMA), the European Aviation Safety Agency (EASA), and the Body of European Regulators of Electronic Communications (BEREC). Member States are represented in

¹ See generally Giandomenico Majone, 'The New European Agencies: Regulation by Information' (1997) 4 *Journal of European Public Policy* 262; Alexander Kreher, 'Agencies in the European Community – A Step Towards Administrative Integration in Europe' (1997) 4 *Journal of European Public Policy* 225; Miroslava Scholten and Marloes van Rijsbergen, 'The Limits of Agencification in the European Union' (2014) 15 *German Law Journal* 1223. Note there are also a number of executive agencies, which do not produce 'soft law', but assist the Commission in managing certain specific tasks.

² Marloes van Rijsbergen, 'On the Enforceability of EU Agencies' Soft Law at the National Level: The Case of the European Securities and Markets Authority' (2014) 10 *Utrecht Law Review* 116

these agencies, for example by way of participation in their management board and through staffing. Often, these agencies operate as a 'network' as their organisational form allows for the participation of national authorities.³

In the wake of the financial crisis of 2008, the EU established the European System of Financial Supervision including three new EU agencies.⁴ These are known as the three European Supervisory Authorities (ESAs, or 'the Authorities'), each covering distinct areas of finance: the European Securities and Markets Authority, the European Banking Authority, and the European Insurance and Occupational Pension Authority.⁵ The Authorities support important projects for the single market. For example, the single market for banking services, known as the Banking Union, aims for deeper integration of the banking system within Eurozone countries, including a stronger rulebook, supervisory system, and resolution regime.⁶ Likewise, the single

³ Saskia Lavrijssen and Leigh Hancher, 'Networks on Track: From European Regulatory Networks to European Regulatory Network Agencies' (2009) 36 *Legal Issues of Economic Integration* 23.

⁴ Jacques de Larosi re, *The High-Level Group on Financial Supervision in the EU – Report* (European Commission, 25 February 2009) <https://ec.europa.eu/economy_finance/publications/pages/publication14527_en.pdf> accessed 18 June 2022.

⁵ See generally Niamh Moloney, 'EU Financial Market Regulation after the Global Financial Crisis: "More Europe" or More Risks?' (2010) 47 *Common Market Law Review* 1317; Eddy Wymeersch, 'The European Financial Supervisory Authorities or ESAs', in Eddy Wymeersch, Klaus J Hopt and Guido Ferrarini (eds), *Financial Regulation and Supervision. A Post-Crisis Analysis* (Oxford University Press 2012).

⁶ See e.g. Danny Busch and Guido Ferrarini (eds), *European Banking Union*, (Oxford University Press 2015); Jens-Hinrich Binder and Christos Gortsos, *The European Banking Union: A Compendium* (CH Beck, Hart, Nomos 2016); 'What is the Banking Union?' (European Commission) <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/banking-union/what-banking-union_en> accessed 18 June 2022.

market for capital, the Capital Markets Union, aims for more resilient and deeper integrated capital markets within the EU.⁷

In 2010, the Authorities were established under the original ESA Regulations.⁸ Over time, their powers gradually increased, casting uncertainty on the limitations and legitimacy of their authority.⁹ The new ESA Regulations in 2019 entail a number of significant changes that may impact the Authorities' soft rule-making powers.¹⁰ The main questions of

⁷ See e.g. 'What is the Capital Markets Union' (European Commission) <https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/what-capital-markets-union_en> accessed 18 June 2022.

⁸ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ L331/12 (EBA Regulation); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC [2010] OJ L331/48; Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L331/84 (ESMA Regulation) (collectively, ESA Regulations).

⁹ See e.g. Madalina Busuioc, 'Rule-Making by the European Financial Supervisory Authorities: Walking a Tight Rope' (2013) 19 *European Law Journal* 111; Marta Simoncini, 'Legal Boundaries of European Supervisory Authorities in the Financial Markets: Tensions in the Development of True Regulatory Agencies' (2015) 34 *Yearbook of European Law* 319; Jakob Schemmel, 'The ESA Guidelines: Soft Law and Subjectivity in the European Financial Market – Capturing the Administrative Influence' (2016) 23 *Indiana Journal of Global Legal Studies* 455; Elizabeth Howell, 'EU Agencification and the Rise of ESMA: Are Its Governance Arrangements Fit for Purpose?' (2019) 78 *Cambridge Law Journal* 324.

¹⁰ Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation

this article are whether the changes solve the legitimacy issues they aimed to tackle and whether the new powers bring to light any new legitimacy concerns. Although there exists a body of literature addressing the growing powers and legitimacy, the question can now be answered more fully following the entry into force of the new 2019 ESA Regulations.¹¹ For this purpose, an assessment framework to identify and evaluate potential legitimacy concerns with regard to EU agencies is used. This framework sets out the relevance for this article of the delegation of powers, the evolution of the case law regarding the legitimacy of EU agencies, as well as the notions of input, throughput, and output legitimacy as set out by Majone, Scharpf, and Schmidt. These conceptual tools as well as the existing case law can then be used to evaluate the ESAs soft law instruments under the new ESA Regulations and to evaluate whether the amendments to the original ESA Regulations effectively addressed existing legitimacy issues. Some legal instruments, such as the No-Action Letter, are novel and could potentially provide the ESAs with innovative new powers, meriting a thorough examination. Another novelty is the appeal mechanism contained in Article 60a of the new ESA Regulations. It merits closer examination on how it will work in practice.

In short, this article aims to set out, in a practical way, the evolution of the case law, the previous ESA Regulations, and the potential of the new ESA

(EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds [2019] OJ L334/1 (ESA Amendment).

¹¹ See e.g. Niamh Moloney, *The Age of ESMA: Governing EU Financial Markets* (Hart 2018); Danny Busch, 'A Stronger Role for the European Supervisory Authorities in the EU27' in Danny Busch, Emiliós Avgouleas and Guido Ferrarini (eds), *Capital Markets Union in Europe* (Oxford University Press 2018).

Regulations in terms of improving legitimacy of the ESAs soft rule-making powers. In doing so, it adds to the existing body of literature developed in anticipation of the new ESA Regulations.¹² This article proceeds as follows: Section II provides an assessment framework, followed in Section III by a brief historical overview of the legislation creating the ESAs and the European System of Financial Supervision. Section IV examines the ESA soft law instruments under both the original and amended legal framework. This sets the stage for the application of a legitimacy framework to the ESAs' legal framework and soft law instruments in Section V. It is argued that the changes in these new regulations are significant and have an impact on the Authorities' soft rule-making powers. The final section concludes that, although a number of legitimacy problems targeted by the ESA review have been resolved, new legitimacy issues have arisen.

II. LEGITIMACY CONCERNS AROUND EU AGENCIES

1. No Legal Basis for the Delegation of Powers to EU Agencies

EU agencies are an increasingly important part of the Union's institutional framework, however their exercise of soft rule-making powers raise legitimacy concerns. In particular, neither the establishment nor the delegation of regulatory powers to EU agencies are explicitly regulated in the EU Treaties. Agencies are established by secondary law instruments, often regulations, on the legal basis of specific Treaty provisions such as Articles 114 and 352 TFEU.¹³ These provisions confer powers on the EU to develop (substantive) laws and policies in different areas, but the EU legislature has interpreted them so as to also include the power to establish Union organs tasked with supervising and/or facilitating implementation of (substantive) laws and policies.

¹² Ibid.

¹³ See Pieter van Cleynenbruegel, 'Meroni Circumvented? Article 114 TFEU and EU Regulatory Agencies' (2014) 21 Maastricht Journal of European and Comparative Law 64, specifically criticizing the legal basis.

There is further no ex ante regulation in primary law of EU agencies' powers. Such rule-making was not foreseen in the Union's hierarchy of norms – which is the ranking of acts according to 'the democratic legitimacy of their respective authors and adoption procedures' as laid down in Articles 288–291 TFEU.¹⁴ The Treaty of Lisbon also merely introduced ex post review in Articles 263 ('action for annulment') and 267 TFEU ('preliminary rulings'). This means that the lawfulness of EU agency acts can only be assessed after they have taken effect.

Such review is particularly difficult in the absence of prior regulation of EU agency powers. The non-regulation of EU agencies gives rise to uncertainty as to their rule-making competence. In the absence of a general legal framework allowing for the delegation of general implementing powers to entities other than the Commission and the Council, the powers of EU agencies are still subject to the constitutional limits formulated by the Court of Justice of the European Union (CJEU) in its case-law.

2. Evolution of the Case Law on the Delegation of Powers to EU Agencies¹⁵

The CJEU ruled in the 1958 *Meroni* judgment that delegation of power was possible in principle, but not in all cases. It distinguished two categories of powers: 'clearly defined executive powers the exercise of which can be subject to strict review in the light of objective criteria determined by the delegating authority' and 'discretionary powers, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy'.¹⁶ The CJEU accepted the

¹⁴ Koen Lenaerts and Marlies Desomer, 'Towards a Hierarchy of Legal Acts in the European Union? Simplification of Legal Instruments and Procedures' (2005) 11 *European Law Journal* 744, 745.

¹⁵ This subsection is largely based on Miroslava Scholten and Marloes van Rijsbergen, 'The ESMA-Short Selling Case: Erecting a New Delegation Doctrine in the EU upon the *Meroni-Romano* Remnants' (2014) 41 *Legal Issues of Economic Integration* 389.

¹⁶ Case 9/56 *Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community (Meroni)* EU:C:1958:7, para 152.

delegation of the first kind of powers, but concluded that the second kind hindered the balance of powers guaranteed by the Treaties.¹⁷ As a consequence, general rule-making powers cannot be delegated.

Another important case is the 1981 *Romano* judgment, in which the CJEU established an additional non-delegation criterion: the Council was not able to delegate to EU agencies the power to adopt acts 'having the force of law'.¹⁸ In its reasoning, the CJEU referred in this specific case to: (i) the judicial system which, at that moment, did not provide for a remedy against the acts of bodies such as an EU agency; and (ii) Article 155, paragraph 4 EEC, which prescribed that it was only for the Commission to exercise executive powers and hence to issue legally binding decisions.¹⁹ The delegation in question was therefore considered to be unlawful because, under the EEC Treaty, agencies were not envisaged among the possible authors of legally binding decisions and no judicial review of agency decisions was possible.²⁰

In the more recent *ESMA Short-selling* case, the CJEU established a new delegation standard by allowing the delegation of powers to issue legally-binding and generally applicable measures, but only if these powers are subject to sufficiently delineating conditions, criteria limiting discretion and amenable to judicial review in the light of the objectives established by the delegating authority.²¹ The main factor behind this relaxation of the delegation doctrine was the Lisbon Treaty, which recognizes the existence

¹⁷ Ibid paras 151–152.

¹⁸ Case 98/80 *Giuseppe Romano v Institut national d'assurance maladie-invalidité (Romano)* EU:C:1981:104, para 20.

¹⁹ Merijn Chamon, 'Le recours à la soft law comme moyen d'éviter les obstacles constitutionnels au développement des agences de l'UE' (2013) 567 *Revue de l'Union Européenne* 152, 155.

²⁰ Ibid.

²¹ C-270/12 *United Kingdom v. European Parliament and Council (Short selling)* C:2014:18. See also Scholten and van Rijsbergen, 'The ESMA-Short Selling Case' (n 15) 401; Carl Fredrik Bergström, 'Shaping the New System of Delegation of Powers to EU Agencies: *United Kingdom v. European Parliament and Council (Short Selling)*' (2015) 52 *Common Market Law Review* 219.

of EU agencies (at least indirectly). In other words, it overturns, at least in part, the Meroni-Romano non-delegation standard. In the *ESMA-short selling case*, the CJEU stated that Romano's ban on delegating powers with 'the effect of law' was effectively outdated by the Lisbon Treaty. It argued that Articles 263 and 277 TFEU imply the possibility to create EU agencies with powers to issue acts of general application and explicitly establish judicial review of EU agencies' acts.²² In the CJEU's reasoning, Articles 263 and 277 TFEU therefore went beyond presuming the existence of such regulatory powers; in fact, they constituted them.²³

Under the Lisbon Treaty, the powers that the Union legislature can give to EU agencies can therefore include discretionary powers transferring a part of the responsibility from the legislature to the agency.²⁴ Nonetheless, the delegation of general rule-making powers to EU agencies is still excluded.²⁵ The delegation of soft regulatory powers to EU agencies, however, appears to bypass the case law restrictions, which have therefore not prevented the

²² *Short selling* (n 21).

²³ See Heikki Marjosola, 'Bridging the Constitutional Gap in EU Executive Rule-making: The Court of Justice Approves Legislative Conferral of Intervention Powers to European Securities and Markets Authority: Court of Justice of the European Union (Grand Chamber) Judgment of 22 January 2014, Case C-270/12, *UK v. Parliament and Council* (Grand Chamber)' (2014) 10 *European Constitutional Law Review* 500.

²⁴ Compare with *Meroni* (n 16) 152, in which the Court explicitly prohibited the delegation of 'discretionary power, implying a wide margin of discretion which may [...] make possible the execution of actual economic policy'.

²⁵ Note that this is different for the supervisory and intervention powers of ESMA. These powers are circumscribed by various conditions and criteria that limit the agency's discretion. They are precisely delineated and amenable to judicial review and therefore do not imply a 'very large measure of discretion' incompatible with the EU Treaty. See also: Marloes van Rijsbergen and Jonathan Foster, "'Rating" ESMA's accountability: "AAA" status' in Miroslava Scholten and Michiel Luchtman (eds), *Law Enforcement by EU Authorities. Implications for Political and Judicial Accountability* (Edward Elgar 2017).

allocation of soft rule-making powers to EU agencies.²⁶ Indeed, institutional practice demonstrates that certain EU agencies have developed policy-making activity that comes close to full regulatory powers and 'while these general rule-making powers are soft by the label, they are often hard in practice'.²⁷ The delegation of soft regulatory powers to EU agencies therefore seems to provide a means for circumventing competent legislative and executive bodies in the decision-making process.²⁸

3. *Input, Throughput, and Output Legitimacy*

Although legitimacy concerns and EU law dictate that EU agencies ought not to have far-reaching general rule-making powers, they increasingly obtain them de facto.²⁹ There are differing opinions about the meaning of legitimacy and how it should be analysed.³⁰ These opinions are often based on Majone's concepts of procedural and substantive legitimacy³¹ and Scharpf's ideas on 'input' and 'output' legitimacy.³² Schmidt adds to this the

²⁶ LAJ Senden and A van den Brink, 'Checks and Balances of Soft EU Rule-Making' (2012) European Parliament Study PE 462.433 <[http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL-JURI_ET\(2012\)462433](http://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL-JURI_ET(2012)462433)> accessed 18 June 2022, 65.

²⁷ Ibid 23.

²⁸ Marta Simoncini, 'The Erosion of the Meroni Doctrine: The Case of the European Aviation Safety Agency' (2015) 21 *European Public Law* 309, 320.

²⁹ Senden and van den Brink (n 26) 65.

³⁰ Gráinne De Búrca, 'The Quest for Legitimacy in the European Union' (1996) 59 *Modern Law Review* 3; Joanne Scott, 'Law, Legitimacy and EC Governance: Prospects for Partnership' (1998) 36 *Journal of Common Market Studies* 175; Giandomenico Majone, 'The Regulatory State and Its Legitimacy Problems' (1999) 22 *West European Politics* 1; Mark Bovens, Deirdre Curtin and Paul 't Hart, 'The Quest for Legitimacy and Accountability in EU Governance' in Mark Bovens, Deirdre Curtin and Paul 't Hart (eds), *The Real World of EU Accountability: What Deficit?* (Oxford University Press 2010) 9.

³¹ Giandomenico Majone, *Regulating Europe* (Routledge 1996).

³² Fritz Scharpf, *Governing in Europe: Effective and Democratic* (Oxford University Press 1999).

notion of 'throughput' legitimacy.³³ This article follows these three normative criteria for the evaluation of legitimacy and uses a number of legal principles to evaluate the extent to which the ESA's soft rule-making powers are legitimate – namely, legality (is there a clear legal basis), transparency, participation, and political and judicial accountability.

A. Input Legitimacy

According to Majone, the first dimension of legitimacy is that of procedural legitimacy.³⁴ Procedural legitimacy suggests regulatory authorities are created by democratically enacted statutes which define their legal authority and objectives (legality); regulators are appointed by representative bodies; decisions are justified and open to judicial review; and regulatory decision-making follows formal rules, which often require public participation.³⁵ As such, procedural legitimacy links with the notion of input legitimacy as it demands that those being affected by a norm have somehow been included in the process of its formulation and that they have a fair chance to scrutinize the results. According to Scharpf, input-oriented democratic thought emphasizes the notion of a 'government by the people'.³⁶ Political choices are legitimate if and because they reflect the 'will of the people'.³⁷ The latter can be determined directly via citizens' participation in the decision-making process or indirectly via their representation through elected delegates.³⁸

B. Output Legitimacy

Majone's second dimension of legitimacy – substantive legitimacy –relates to aspects of the regulatory process such as policy consistency; the expertise and problem-solving capacity of the regulators; the exact boundaries within

³³ Vivien Schmidt, 'Democracy and Legitimacy in the European Union Revisited: Input, Output and 'Throughput' (2013) 61 *Political Studies* 2.

³⁴ Majone, *Regulating Europe* (n 31).

³⁵ *Ibid* 291.

³⁶ Scharpf (n 32) 6.

³⁷ *Ibid*.

³⁸ *Ibid* 7.

which regulators are expected to operate; and their ability to protect diffuse interests.³⁹ As such, substantive legitimacy links with the notion of output legitimacy as these regulatory aspects emphasize the importance of effective policy outcomes. Following this line of thought, political choices are legitimate when they effectively promote the overall welfare of the population in question, i.e. 'government for the people'.⁴⁰ Regulation is output legitimate when the regulatory outcomes are satisfactory. Furthermore, output legitimacy requires the prevention of abuse of political power by holding a regime accountable for its decisions ex post.⁴¹

C. Throughput Legitimacy

Schmidt explains that the quality of governance processes also is an important criterion for the evaluation of a polity's overall democratic legitimacy.⁴² So-called throughput legitimacy concerns the adequacy, accountability and transparency of EU governance processes and policy-making rules' adequacy.⁴³ Here, accountability is understood as EU actors being judged on their responsiveness to participatory input demands and being held responsible both for their output decisions and for their policy-making processes meeting standards of ethical governance.⁴⁴ Transparency entails access to information and publication requirements covering EU institutions' processes and decisions.⁴⁵ Finally, institutional throughput

³⁹ Majone, *Regulating Europe* (n 31) 291-92.

⁴⁰ Scharpf (n 32) 6.

⁴¹ Ibid 13.

⁴² Schmidt (n 33) 2; Vivien Schmidt and Matthew Wood, 'Conceptualizing Throughput Legitimacy: Procedural Mechanisms of Accountability, Transparency, Inclusiveness and Openness in EU Governance' (2019) 97 *Public Administration* 727.

⁴³ Schmidt (n 33) 6.

⁴⁴ Carol Harlow and Richard Rawlings, 'Promoting Accountability in Multi-level Governance' (2007) 13 *European Law Journal* 542.

⁴⁵ Adrienne Héritier, 'Composite Democracy in Europe: The Role of Transparency and Access to Information' (2003) 10 *Journal of European Public Policy* 814.

concerns the quality and quantity of EU governance processes' inclusiveness and the openness of the EU's various institutional bodies to 'civil society'.⁴⁶

III. THE CASE OF THE EUROPEAN SYSTEM OF FINANCIAL SUPERVISION

The ESAs started operating in January 2011, deriving their powers from a series of European Regulations.⁴⁷ ESAs play an important role in the development of EU financial sector regulation. ESAs can be described as networks of national regulators⁴⁸ as they set up working groups and committees for national financial regulator experts to decide on technical details of European financial regulation. As the national experts lack democratic credentials, the ESA working groups and committees give rise to legitimacy concerns and questions regarding their place within the EU's constitutional framework.⁴⁹ Arguably, a construct where (soft) rule-making

⁴⁶ Schmidt (n 33) 6-7.

⁴⁷ ESA Regulations.

⁴⁸ See generally Burkard Eberlein and Abraham L Newman, 'Escaping the International Governance Dilemma? Incorporated Transgovernmental Networks in the European Union' (2008) 21 *Governance: An International Journal of Policy, Administration, and Institutions* 25; Lavrijssen and Hancher (n 3); Marco Zinzani, *Market Integration through 'Network Governance': The Role of European Agencies and Networks of Regulators* (Intersentia 2012). The same concept is applicable at transnational level. See generally Pierres-Hugues Verdier, 'Transnational Regulatory Networks and Their Limits' (2009) 34 *Yale Journal of International Law* 113; Ebbe Rogge, 'Transnational Financial Rulemaking: An Application of Comparative Law & Global Legal Pluralism' (2019) 39 *Review of Banking and Financial Law* 499. But see also Anne-Marie Slaughter, 'The Real New World Order' (1997) 76(5) *Foreign Affairs* 183. For the ESAs' role at transnational level, see Niamh Moloney, 'International Financial Governance, the EU, and Brexit: The "Agencification" of EU Financial Governance and the Implications' (2016) 17 *European Business Organisation Law Review* 451.

⁴⁹ At the international level, the issue of whether there is a democratic deficit in international organizations being comprised of e.g. national regulators is raised by, for example, Slaughter (n 48); David Zaring, 'International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations' (1998) 33 *Texas International Law Journal* 281; and Verdier

powers are devolved to experts rather than elected representatives may warrant further democratic checks and balances. How these checks and balances fit within the European constitutional framework is an important part of the main questions posed in this article, in particular in light of the ever-expanding role and powers bestowed upon European regulatory bodies.

EU financial regulation is developed through the so-called Lamfalussy process, which is made up of four levels.⁵⁰ The first level relates to the passing of relevant EU legislation i.e., Directives and Regulations by the European Parliament and Council. At the second level, the Authorities develop draft regulatory technical standards or implementing technical standards on the basis of the level one texts and submit them to the Commission for endorsement. The Commission adopts level two regulatory technical standards and implementing technical standards by means of a delegated act⁵¹ or implementing act,⁵² respectively. This distinction between level one and two texts allows Parliament and Council to focus on the broad political lines, leaving the design of the technical details to the regulatory experts. ESAs have a large degree of discretion when developing draft technical standards. Given the agencies' technical expertise, the Commission has stated

(n 48). At the European level, see for example Marloes van Rijsbergen, *Legitimacy and Effectiveness of ESMA's Soft Law* (Edward Elgar 2021).

⁵⁰ See generally *Regulatory Process in Financial Services* (European Commission) <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-reforms-and-their-progress/regulatory-process-financial-services/regulatory-process-financial-services_en>, accessed 18 June 2022. See also Niamh Moloney, 'The European Securities and Markets Authority: A Perspective from One Year On' (2013) 68 *Zeitschrift für öffentliches Recht* 59, explaining that ESMA's rule-making powers include assisting the EC in formulating and adopting a single rulebook applicable to all EU financial institutions.

⁵¹ Consolidated Version of the Treaty on European Union [2008] OJ C115/13 (TEU) art 290.

⁵² *Ibid* art 291.

it will, as a rule, rely on ESA submitted drafts.⁵³ These drafts are generally only rejected when there are strong reasons to believe they will not work. Rejection is unlikely, because the ESAs have done consultative work and collaborated with the stakeholders during the drafting process.⁵⁴ At the third level of the Lamfalussy process, the Authorities issue guidelines and recommendations to ensure a consistent interpretation of Directives and Regulations across all Member States. The Authorities increasingly make use of non-binding instruments such as opinions and Q&As. Finally, at the fourth level, the Commission ensures the consistent enforcement of Directives and Regulations across Member States.

In January 2020, important changes to the Authorities' legislative framework entered into force. These changes largely aimed at strengthening the ESAs' legitimacy. The changes are based on the so-called ESA-review of September 2017,⁵⁵ in which the Commission put forward proposals to reinforce the coordination role of the Authorities. On 21 March 2019, the European Parliament and Member States agreed on the core elements of reforming the European supervision in the area of EU financial markets.⁵⁶ This agreement was regarded as an important step to ensure a fully functioning Capital Markets Union and Banking Union. It reinforced the role and powers of the Authorities by ensuring convergence of supervisory

⁵³ ESMA Regulation, as amended by ESA Amendment.

⁵⁴ van Rijsbergen, *Legitimacy and Effectiveness of ESMA's Soft Law* (n 49).

⁵⁵ 'Public Consultation on the Operations of the European Supervisory Authorities' (European Commission) <https://ec.europa.eu/info/consultations/public-consultation-operations-european-supervisory-authorities_en> accessed 18 June 2022. Within the framework of this revision, the European Commission might take decisions or actions regarding the ESAs' establishing regulations.

⁵⁶ 'Press Release: Capital Markets Union: Political Agreement on a Stronger and More Integrated European Supervisory Architecture, including on Anti-Money Laundering' (European Commission, 21 March 2019) <https://ec.europa.eu/commission/presscorner/detail/en/IP_19_1655> accessed 18 June 2022.

outcomes, a level playing field for financial institutions and investors, and financial integration generally within the Single Market.⁵⁷

IV. SOFT LAW INSTRUMENTS BEFORE AND AFTER THE ESA REVIEW

The ESAs can use a wide range of regulatory and guidance tools directly provided for in their founding Regulations. These may be categorised as: 1) draft regulatory and implementing technical standards, which are of a quasi-binding preparatory nature; 2) guidelines and recommendations, subject to 'comply-or-explain' for the national authorities; and 3) non-binding instruments such as opinions and Q&As, which are of a completely voluntary nature.⁵⁸ The sections below provide a brief overview of what the three categories of soft law instruments are, what soft law function they fulfil (pre-law, post-law or para-law) and on what basis the ESAs may exercise their powers.⁵⁹ This section also describes that the most important changes to the Authorities' legal framework aimed at improving the legitimacy of their soft law instruments include the introduction of 'no-action letters', modifications to non-binding instruments such as opinions and Q&As, and a possibility for market participants to address possible *ultra vires* problems at the European Commission.

1. Draft Regulatory and Implementing Technical Standards

At the second level of the Lamfalussy process – and in areas specifically set out in legislative acts referred to in Article 1(2) of the ESA Regulations – Authorities are empowered to develop two kinds of formally non-binding draft technical standards: *regulatory technical standards* and *implementing technical standards*.⁶⁰ The former are a delegation of quasi-rulemaking

⁵⁷ Ibid.

⁵⁸ For a full analysis of these three categories of ESMA's soft law, see van Rijsbergen, *Legitimacy and Effectiveness of ESMA's Soft Law* (n 49).

⁵⁹ For an elaborate explanation on the three main functions of Union soft law, see Linda Senden, *Soft Law in European Community Law* (Hart 2004) 119–20.

⁶⁰ ESMA Regulation, arts 10–15.

authority from the EU's legislative institutions.⁶¹ These draft regulatory technical standards are considered as soft law until adopted by Commission *delegated acts* under Article 290 TFEU. The latter, implementing technical standards, are more operational, with an implementing quality, and so, in effect, represent a form of delegation of powers from the Member States.⁶² They are adopted by the Commission by means of *implementing acts* under Article 291 TFEU. Since the Authorities' draft technical standards are adopted with a view to elaborating and preparing future Union legislation and policy, they fulfil a *pre-law function*.

Before the ESA Review, and in accordance with the old Article 8(2)(a) and (b) of the ESA Regulations, agencies had the power to develop draft regulatory and implementing technical standards, or level two legislation, in the specific cases referred to in Articles 10 and 15. This provision limits the development of draft technical standards to 'specific cases'. Therefore the level one legislation needs to contain an explicit requirement or invitation for the Authorities to draft level two legislation. Articles 10 to 15 of the ESA Regulations provide only the procedural framework for developing this type of legal instrument, and thus do not establish the legal basis. Instead, the legal basis for this regulatory power has to arise from specific sectoral legislation. The Authorities do not have the power to draft level two legislation *on their own initiative*: they may do so only in accordance with the specific mandate provided in level one (financial) legislation. Ultimately, the EU's institutional balance of powers requires that each institution act in accordance with the principle of conferral and in line with the inter-institutional division of powers which bestows on the Commission the right of initiative.

The power to draft regulatory and implementing technical standards flows from Articles 10 and 15 of the new ESA Regulations. These articles were

⁶¹ Moloney, 'International Financial Governance, the EU, and Brexit' (n 48) 66.

⁶² Niamh Moloney, 'Reform or Revolution? The Financial Crisis, EU Financial Markets Law and the European Securities and Markets Authority' (2011) 60 *International & Comparative Law Quarterly* 529, 530.

streamlined but not substantially modified content-wise. Importantly, the Authorities are still only allowed to develop technical standards where they are explicitly mandated to do so by a level one text. In other words, Authorities develop such technical standards only where the Parliament and Council delegate to the Commission the power to adopt technical standards pursuant to Article 290 or 291 TFEU. When the Commission receives draft technical standards, they are forwarded to the Parliament and Council. The draft technical standards need to be adopted within three months.

2. Guidelines and Recommendations

The ESAs' *guidelines and recommendations* are addressed to national supervisory authorities or financial market participants. They aim to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision, and ensure the common, uniform and consistent application of EU law.⁶³ While not legally binding *stricto sensu*, these are not merely voluntary or without legal effect and aim to influence the actions of the addressees.⁶⁴ Since national supervisory authorities and financial market participants are required to make every effort to comply with ESA guidelines and recommendations, these are referred to as 'comply or explain' instruments.⁶⁵ The Authorities' guidelines fulfil a *post-law function*, because they are adopted after the level one legislation entered into force in order to correctly interpret and support the proper implementation of that legislation in the Member States.⁶⁶

⁶³ ESMA Regulation, art 16(1).

⁶⁴ Dorothee Fischer-Appelt, 'The European Securities and Markets Authority: The Beginnings of a Powerful European Securities Authority?' (2011) 5 *Law and Financial Markets Review* 21, 25; Pierre Schammo, *EU Prospectus Law. New Perspectives on Regulatory Competition in Securities Markets* (Cambridge University Press 2011) 1881; Wymeersch (n 5) 276.

⁶⁵ ESMA Regulation, art 16(3).

⁶⁶ Senden (n 59) 119-20.

The most obvious legal basis for the Authorities' guidelines and recommendations, or level three legislation, is in Article 16 of the ESA Regulations. In contrast with the Authorities' draft technical standards, Article 16(1) of the old ESA Regulations empowers the agency directly and explicitly to issue guidelines and recommendations addressed to competent authorities or financial institutions. Therefore, the level one legislation does not need to provide the Authorities with a legal basis for adopting guidelines and recommendations, even though on many occasions such empowerment is explicitly provided for. In a more recent development, guidelines and recommendations are sometimes adopted on the basis of a mandate in the Commission's delegated or implementing acts (or level two acts), which – quite remarkably – are based on the interpretations provided by the Authorities themselves. This is the case for instance for ESMA's Guidelines on the validation and review of Credit Rating Agencies' methodologies.⁶⁷ Since Article 16(1) directly empowers the agency, the power to issue guidelines and recommendations is available to the Authorities *on their own initiative*.

In the new ESA Regulations, Article 16 is amended slightly compared with its previous wording. Paragraph 1 makes it clear that guidelines are intended for all competent authorities or all financial institutions, whilst recommendations are intended for one or more competent authorities or one or more financial institutions. In accordance with paragraph 2, the Authorities still have to conduct a public consultation and provide a cost benefit analysis where appropriate. The difference is that the Authorities will now be required to provide reasons if they choose not to consult or present a cost benefit analysis, which is an improvement from the perspective of transparency. Additionally, under a new paragraph 2a, the Authorities are

⁶⁷ ESMA, 'Guidelines on the Validation and Review of Credit Rating Agencies' Methodologies' (2017) ESMA/2016/1575 <https://www.esma.europa.eu/sites/default/files/library/2016-1575_guidelines_on_cras_methodologies_1.pdf>

required to ensure that any new guidelines and recommendations do not merely duplicate level one text or existing guidelines and recommendations.

3. *Non-binding Instruments including Opinions and Q&As*

The Authorities may issue a variety of non-binding instruments through which they provide scientific and technical assistance to the national authorities and financial market participants in their daily practice. Under the old ESA Regulations, those included: 1) *opinions* directed towards national supervisory authorities for the purposes of building a common Union supervisory culture and building consistent supervisory practices (Article 29(1)(a) ESA Regulations); 2) *opinions and technical advice* to the European Parliament, Council and the Commission (Article 16a), *Q&As* (Article 16b); and 3) *new practical instruments and convergence tools* to promote common supervisory approaches and practices (Article 29(2) ESA Regulations)⁶⁸ such as supervisory briefings. Such non-binding instruments are not subject to the 'comply or explain' mechanism and leave a wide discretion to their addressees, despite containing interpretations of financial regulation that Authorities and national authorities may apply in their supervisory practices. There is a serious risk that the underlying binding legislation will be breached if the interpretations in the non-binding instruments are not adhered to. Non-binding instruments also fulfil a *post-law function*, which means they are adopted subsequent to existing Union law in order to supplement and support secondary Union law.⁶⁹ Their

⁶⁸ This abbreviation stands for Questions & Answers. They enable ESMA to publish frequently asked questions which it receives from supervised entities and to provide clarifications on matters within its competence in a quick and efficient way where a more articulated explanation such as the one used in the guidelines is not required. Given the fact that Q&As provide guidance, they always need to be approved and adopted by the Board of Supervisors. For a list of all Q&As, see 'Questions and Answers' (ESMA) <www.esma.europa.eu/questions-and-answers> accessed 18 June 2022.

⁶⁹ Senden (n 59) 119-20.

purpose is to ensure the correct interpretation of existing Union law in the Member States.

The new ESA Regulations lay down general empowerments for the Authority to issue, on its own initiative, non-binding instruments. As Authorities in fact have a *carte blanche* with regard to the development of such instruments and tools, the legislature does not need to provide any express legal basis in the level one legislation. As such, one could speak of a *general* competence allocation.

Provisions allowing for the development of non-binding instruments have changed substantially in the new ESA Regulations. Under the original ESA Regulations, Opinions were provided for under Article 34 'Other tasks', first paragraph. This states that the Authorities 'may, upon a request from the European Parliament, the Council or the Commission, or on its own initiative, provide opinions to the European Parliament, the Council and the Commission on all issues related to its area of competence'. In the new ESA Regulations, this has been expanded upon by the introduction of Article 16a 'Opinions'. Opinions are thus placed together with guidelines and recommendations, as well as Q&As. Although the first paragraph of Article 16a on the providing of opinions is identical to the old Article 34, the following paragraphs now include more details. The second paragraph is important, because it explains that these opinions may, upon the request of one of the Union institutions, include a public consultation or technical analysis.

Whereas Q&As previously were used as a new convergence tool on the basis of Article 29(2) of the old ESA Regulations, they are now covered under Article 16b of the new ESA Regulations and have been strengthened considerably. Any natural or legal person may submit questions to the Authorities, Union institutions and bodies and national competent authorities, although it is stated that financial institutions must consider approaching their national competent authority first (para 1). The Authorities must provide answers in the language in which the question was

asked (para 2). Furthermore, the Authorities must publish the questions and answers concerned using a web-based tool, also when answers are not yet available or when questions that they do not intend to answer are rejected (para 3). Upon the instigation of three voting members of the Board of Supervisors, the Board is further able to request the relevant agency to obtain advice from the Stakeholder Group, to conduct a public consultation, or to carry out a cost-benefit analysis (para 4). Where questions require the interpretation of Union law, the answer must be provided by the Commission, but published by the Authorities (Para 5).

4. No-Action Letters

Perhaps the ESA Review's most eye-catching addition are the so-called 'no-action letters'.⁷⁰ This concept has been mentioned by stakeholders in their responses to the earlier Commission consultation on the operation of the Authorities.⁷¹ The idea appears to be based upon powers granted to U.S. financial regulators, such as the Securities and Exchange Commission (SEC). An SEC-regulated firm may request a 'no-action letter' from the SEC in respect of a course of action the firm wants to take.⁷² An example would be where a financial institution, regulated by the SEC, wants to offer a new product or service but is uncertain whether this is allowed under current regulation. For legal certainty and transparency reasons, the financial institution can ask the SEC before the actual development of the product or service whether the SEC would allow it. In such a case, the SEC may issue a 'no-action letter', indicating that the SEC believes it is most likely allowed

⁷⁰ 'ESA Review' (ESMA) <<https://www.esma.europa.eu/about-esma/who-we-are/esa-review>> accessed 18 June 2022.

⁷¹ 'Feedback Statement on the Public Consultation on the Operations of the European Supervisory Authorities Having Taken Place from 21 March to 16 May 2017 (European Commission, 20 June 2017) <https://ec.europa.eu/info/sites/info/files/2017-esas-operations-summary-of-responses_en.pdf> accessed 18 June 2022.

⁷² *No Action Letters* (US Securities and Exchange Commission) <<https://www.sec.gov/fast-answers/answersnoactionhtm.html>> accessed 18 June 2022.

and that the SEC would not take retrospective action against the financial institution on these matters.

'No-action letters' were introduced in the ESA Review, and are now established in Article 9a of the new ESA Regulations.⁷³ ESA 'no-action letters' operate differently from their U.S. namesakes. The European 'no-action letters' are not addressed to individual firms but concern an issue for the market as a whole. These letters seek non-enforcement by national competent authorities of particular provisions within a level one Directive or Regulation or a level two delegated or implementing act causing some form of market disruption or other difficulties for market participants. The Authorities may use the new powers where such a level one text is 'liable to raise significant issues' in at least one of the following three situations as per Article 9a(1): 1) in case there is a conflict with another relevant act; 2) if the absence of delegated or implementing acts complementing or specifying the act would raise legitimate doubts concerning the legal consequences flowing from the act or its proper application; or 3) if the absence of guidelines and recommendations would raise practical difficulties concerning the application of the relevant act. The Authorities could arguably already resolve the third situation using their power under Article 16 of the old ESA Regulations by way of developing guidelines or recommendations. The first and second situation, however, were previously not within the Authorities' powers.

In all three of the above situations, the Authority will send a 'no-action letter' setting out its views of the issues to the national competent authorities and the Commission. The Authority must, if necessary, issue opinions under Article 9a(2) and (3) to ensure consistent supervisory and enforcement practices, and consistent application of Union law. The Authority has discretion to issue such opinions under paragraph (4). In this opinion, the Authority provides the Commission with its views on the level of urgency

⁷³ In case of the EBA Regulation, it is Article 9c, as 9a and 9b concern anti-money laundering.

and any action it considers appropriate. This may include new level one legislation, new delegated acts, or new implementing acts. The opinion is made public by the ESA once it is adopted by its Board of Supervisors.

The 'no-action letter' has already been used in practice. On 29 April 2020 ESMA sent the Commission such a letter in order to assess the new Economic, Social, and Governance (ESG) disclosure requirements under Articles 13(1)(d) and 27(2a) of the Benchmark Regulation (EU) 2016/1011.⁷⁴ Benchmark administrators had difficulties complying with said disclosure requirements, which were due to apply by 30 April 2020, in the absence of relevant Delegated Acts. These compliance issues arise because level two Delegated Acts will contain necessary details of what to include in the disclosure.⁷⁵ Alongside this letter, ESMA provided two opinions: 1) to the Commission and national competent authorities under Article 9a(2), setting out its views on the issues,⁷⁶ and 2) to the national competent authorities under Article 9a(3), as regards consistent supervisory and enforcement practices.⁷⁷ ESMA argued that the entry into force of disclosure requirements and of the related Delegated Acts should coincide, and in any event the

⁷⁴ 'Press Release: ESMA Issues No Action Letter on the New ESG Disclosure Requirements under the Benchmarks Regulation' (ESMA) <<https://www.esma.europa.eu/press-news/esma-news/esma-issues-no-action-letter-new-esg-disclosure-requirements-under-benchmarks>> accessed 18 June 2022.

⁷⁵ Note that the Delegated Acts setting out the detailed disclosure requirements are actually mandated under Article 27(2b) of the Benchmark Regulation.

⁷⁶ ESMA, 'No Action Letter on Sustainability-related Disclosures for Benchmarks' (2020) ESMA41-137-1300 <https://www.esma.europa.eu/sites/default/files/library/esma41-137-1300_esmar_article_9a3_opinion_-_bmr_nca.pdf> accessed 18 June 2022. Note that this is actually an opinion rebranded as 'no-action letter'.

⁷⁷ ESMA, 'Opinion of the European Securities and Markets Authority of 29 April 2020 on Appropriate Action in Respect of the New Disclosure Requirements in Regulation (EU) 2016/1011 of the European Parliament and of the Council Relating to the Sustainability-related Disclosures for Benchmarks' (2020) ESMA41-137-1299 <https://www.esma.europa.eu/sites/default/files/library/esma41-137-1299_esmar_article_9a2_opinion_-_bmr_ec.pdf> accessed 18 June 2022.

former should not come before latter. As it cannot disapply Union law, ESMA suggested that national competent authorities must not prioritise supervisory or enforcement action relating to the disclosure requirements in the absence of the Delegated Acts. One could argue that this guidance *de facto* recommends the disapplication of Union law.

V. ASKING THE LEGITIMACY QUESTION – THE SITUATION AFTER THE ESA REVIEW

1. Input Legitimacy: Do No-Action Letters Create a Right of Initiative for the ESAs as Regards Level One and Two Legislation?

A. No-Action Letters in Practice

Under the previous ESA Regulations, the Authorities already had the power to issue guidelines, opinions and Q&As on their own initiative. The right of initiative for legislative texts, i.e. level one and two texts, however, was the exclusive domain of the Commission, with the usual role for the European Parliament and the Council taking on the legislative function. Under the Lisbon Treaty, the delegation of general rule-making powers to EU agencies is still excluded.⁷⁸ The new ESA Regulations however introduce the concept of the 'no-action letter', which raises the question whether the Authorities gain such right of initiative.

When using the 'no-action letters', the Authorities 'must' under Article 9a(2) and (3), and 'may' under (4), submit an opinion to the European Commission in which they actively ask for a change in level one or two texts. This implies that the Authorities get an influence on binding rule-making competences, including on Directives and Regulations, even though this power is only to be used in very specific circumstances. Consider again the example of ESMA's 'no-action letter' in the case of ESG disclosure

⁷⁸ Compare with *Meroni* (n 16) 152, in which the Court explicitly prohibited the delegation of 'discretionary power, implying a wide margin of discretion which may [...] make possible the execution of actual economic policy'.

requirements under the Benchmark Regulation, as discussed earlier: by ensuring the temporary non-enforcement of the Benchmark Regulation, it could be argued that the no-action letter in effect delays the application of a level one text but without, of course, actually amending it. Although it can rightly be argued that the prevention of substantive issues is the underlying cause leading to the delay, this delay would not be realised without the issuance of the 'no-action letter'. It is an interesting input legitimacy puzzle as it may run somewhat counter to the institutional balance of powers within the EU, and it could be regarded as a further entanglement between the ESAs and the Commission.

B. No-Action Letters: A Different Path?

The Authorities commonly draft level two texts on the basis of a level one legislative provision i.e. using a top-down competence that has been democratically legitimated by the EU legislature. Level one legislation is adopted pursuant to the ordinary legislative procedure which gives the same weight to the European Parliament and the Council regarding a legislative proposal by the European Commission.⁷⁹ In addition, national Parliaments have a possibility to participate, e.g. in case they would take the view that the draft legal text in question does not comply with the principle of subsidiarity.⁸⁰

Nonetheless, the 'no-action letters' allow for a different path to be taken. It could be argued that the Authorities now have more power to advise the Commission, in a bottom-up way – albeit in specific circumstances only – to make amendments in level one and two texts. This is not to say that this different path is entirely without democratic (input) legitimacy, first because the power to issue a 'no-action letter' is derived from a Regulation, and second because any such proposed amendment would be subject to the usual

⁷⁹ TEU, arts 289(1), 294.

⁸⁰ Protocol on the Application of the Principles of Subsidiarity and Proportionality [2004] OJ C310/207, art 6.

parliamentary processes and scrutiny. Nonetheless, their 'no-action letter' power gives the ESAs an increased influence in the Level 1 sphere. On the one hand, the ESA opinions to the European Commission can be regarded as merely advisory, because the latter is not bound to follow it. On the other hand, the ESA opinions gain further force by the fact that the ESAs have to make their opinions public, which means that the Commission has to explain why it would not give follow-up to one of the ESAs' requests.

According to one view, giving the Authorities a specific tool to address shortcomings causing well-defined issues in financial markets could be regarded as a positive development, in particular from the perspective of output legitimacy. Since the ESAs are expert agencies, their involvement is also very useful, and it is eventually for the EU institutions or representatives of the Member States to decide what to do with the opinions. The ability to exercise such a tool can therefore enhance the quality of EU legislation and contribute to better meeting the goals which the rules aim to achieve. It appears to be a more powerful tool than, for example, a forbearance statement, such as the one issued in the context of COVID-19 and upcoming deadlines for the publication of periodic reports by fund managers.⁸¹ Although both a forbearance statement and a 'no-action letter' may have the same impact for market participants, i.e. de facto disapplication of EU law, the latter allows for the submission of a legislative proposal.

⁸¹ ESMA, 'Public Statement: Actions to Mitigate the Impact of COVID-19 on the Deadlines for the Publication of Periodic Reports by Fund Managers' (2020) ESMA34-45-896 <https://www.esma.europa.eu/sites/default/files/library/esma34-45-896_public_statement_on_publication_deadlines_in_fund_management_area.pdf>, accessed 18 June 2022. See also Niamh Moloney and Pierre-Henri Conac, 'EU Financial Market Governance and the Covid-19 Crisis: ESMA's Nimble, Responsive, and Speedy Response in Coordinating National Authorities through Soft-Law Instruments' (2020) *European Company and Financial Law Review* 363.

2. Throughput Legitimacy: Increased Transparency and Participation as Regards the Opinions and Q&As Process

A. Increased Transparency and Participation

Under the previous ESA Regulations, the Authorities' Q&As and opinions overall lacked transparency. There were no consultation papers, cost-benefit analyses or Stakeholder Group advice preceding the publication of an adopted legal text on the Authorities' websites.⁸² The reason for this being that such requirements did not exist in the framework of adopting opinions and Q&As.⁸³ Hence, only the final acts were published on the Authorities' websites. This had an impact on throughput legitimacy though, in the sense that it was difficult for individuals to understand and accept the guidance laid down in opinions and Q&As. Addressing this issue has been one of the main drivers behind the changes to the new ESA Regulations and solves this throughput legitimacy problem.

Indeed, in the new situation it is a requirement to publish all Q&As on the Authorities' websites, including questions rejected and questions received, even when no answers are yet available. The Authorities' capability to create Q&As is limited because questions concerning the interpretation of Union law must be passed on to the Commission: it is after all within competence of the Commission to provide such interpretation. A further change to the Q&A process is the new power for (any) three members of Board of Supervisors of the Authorities to make a request the (entire) Board for running a public consultation or consulting the formal Stakeholder Group. In the case of opinions, the European Parliament, Council or Commission may submit a similar request to the Authorities. The Union institutions

⁸² With the exception of some examples where ESMA decided to carry out a cost-benefit analysis anyway, e.g. ESMA, 'Technical Advice under the CSD Regulation' (2015) ESMA/2015/1219 <https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1219_-_final_report_csdr_ta_incl_cba_for_ec.pdf> accessed 18 June 2022.

⁸³ Ibid.

previously had this prerogative only when the Authorities developed draft technical standards and issued guidelines and recommendations.

Such consultations increase the transparency of opinions and Q&As as the ESAs will be under a duty to give reasons when publishing their responses to the feedback received from stakeholders. Indeed, stakeholder feedback cannot be simply put aside. Our recommendation is therefore for the Authorities to set up a similar internal procedure as for technical standards and guidelines in order to fulfil their duty to give reasons. In doing so, financial institutions may learn of the reasons and factual and legal considerations underlying the ESAs' choices and consider the guidance documents' legitimacy.

Adding these procedural steps to the decision-making process for opinions and Q&As makes the instruments more throughput legitimate, because they allow for the participation of stakeholders in the decision-making process. However, such procedural steps reduce the process' efficacy as there are more hurdles to overcome. This takes extra time, whereas opinions and Q&As typically were used as an instrument to respond to market changes in an expedited manner, precisely because of their lighter adoption procedure.⁸⁴

B. Practice Issues Regarding Stakeholder Involvement: Regulatory Capture

Naturally, both the publication of Q&As and stakeholder involvement in the process of adopting opinions and Q&As could make the Authority more prone to pressure from the industry. This creates a new throughput legitimacy puzzle in and of itself, which seems most likely to arise when stakeholders' questions are rejected. Indeed, involving industry in the process risks 'regulatory capture': the situation where (regulated) industry itself is

⁸⁴ An example of a situation where a quick response was required is the aforementioned ESMA opinion relating to reporting requirements and COVID-19, see ESMA 'Public Statement: Actions to Mitigate the Impact of COVID-19 on the Deadlines for the Publication of Periodic Reports by Fund Managers' (n 81).

able to control decisions made by their own regulators.⁸⁵ In other words, the industry 'captures' regulatory decision-making, ensuring regulators decide in accordance with what industry prefers regulators to decide.⁸⁶ Stakeholder involvement may thus be seen as a double-edged sword, contributing to agency accountability and control, but with an inevitable risk of dependence on the regulated industry.⁸⁷ This is a risk that should be mitigated because it hinders the agency's independence duties, i.e. it has to operate freely from political, industry, and national interests.⁸⁸ Therefore, a balance needs to be struck between participation and consultation mechanisms, on the one hand, and the independence of the regulator, on the other. The Authorities need to take into account stakeholders' views when drafting the rules but should be careful to retain their own opinions and, in doing so, their discretion.

3. Output Legitimacy: Accountability of the European Supervisory Authorities an Enhanced System of Checks and Balances?

A. Reporting to European Parliament and Council

Fortunately, in order to solve the potential legitimacy problems described above, further safeguards on the new soft law powers of the Authorities are introduced as well. This section demonstrates that the accountability mechanisms of the ESAs to the democratic institutions of the Union are very

⁸⁵ See generally Barry Mitnick, 'Capturing "Capture": Definition and Mechanisms' in David Levi-Faur (ed), *Handbook on the Politics of Regulation* (Edward Elgar 2011); Annetje Ottow, *Market and Competition Authorities: Good Agency Principles* (Oxford University Press 2015).

⁸⁶ Ibid.

⁸⁷ Sarah Arras and Caelesta Braun, 'Stakeholders Wanted! Why and How European Union Agencies Involve Non-State Stakeholders' (2017) 24 *Journal of European Public Policy* 1, 3.

⁸⁸ Independence is important, since it is the most distinctive feature of EU agencies. See Scholten and van Rijsbergen, 'The Limits of Agencification in the European Union' (n 1).

well arranged⁸⁹ and contribute to the throughput and output legitimacy of their regulatory decisions. Article 3 of the original ESA Regulations merely stated that the Authorities 'shall be accountable to the European Parliament and the Council'. This included accountability for the use of their soft law powers. However, what this entails and how the accountability to Parliament should work in practice is set out in far greater detail in Article 3 of the revised ESA Regulations. In perhaps the most conspicuous scenario, the Authorities are required to cooperate with an investigation by the European Parliament commenced under Article 226 TFEU. Such a procedure would require the establishment of a Committee of Inquiry, to be set up by the European Parliament in order to investigate alleged contravention or maladministration in the implementation of Union law (except where a court is already investigating). Additional ways in which the European Parliament can hold the Authorities to account include the annual appearance of the ESA Chairpersons before Parliament and their obligation to, upon request, hold confidential oral discussions with the Chair, Vice-Chairs, and Coordinators of the competent committee of Parliament.

The ESAs have been relieved of their obligation to report annually to the Council and the Commission how they intended to ensure that non-compliant national competent authorities would follow their guidelines and recommendations in the future. Under the new ESA Regulations, they merely have to inform which guidelines and recommendations have been issued.⁹⁰ This is a better reflection of the nature of guidelines and recommendations, which should have no binding effects when a competent authority explained its (intended) non-compliance with a particular set of guidelines or recommendations. The change further reflects the constitutional landscape in which the Authorities operate more appropriately, because national authorities should not be pushed when they

⁸⁹ This was also concluded in relation to ESMA's enforcement powers in *van Rijsbergen and Foster* (n 25) 43.

⁹⁰ ESA Regulations, as amended by ESA Amendment, art 16(4).

have sound reasons for not following-up on guidelines or recommendations. The output legitimacy puzzle lies in the fact that the change is somewhat detrimental to transparency⁹¹ and deprives the ESAs from a possibility to contribute to the achievement of satisfactory regulatory outcomes. After all, the objective of guidelines is to ensure common, uniform and consistent application of Union law. Achieving this objective will be hampered by those national authorities that do not comply.

B. Appeal Mechanism to the European Commission

Additionally, a new accountability mechanism was introduced by means of Article 60a ('exceeding of competence by the Authority').⁹² This created an appeal mechanism before the Commission for any natural or legal person that is of the opinion that the ESA in question has exceeded its competence when issuing guidelines and recommendations under Article 16 or Q&As under Article 16b. The provision requires that the concerned person may send a reasoned advice to the Commission only if the act in question is of direct and individual concern to that person. This includes a failure to respect the principle of proportionality on the part of the ESA.

C. Practical Issues

There are two questions that come to mind when reflecting upon how this new mechanism would legitimately work in practice. The first relates to the uncertainty around legal remedies. A natural or individual person may send a reasoned advice to the Commission, but Article 60a remains silent on what the Commission can or must do when it receives a reasoned advice (e.g. should it require the ESAs to withdraw the soft law act concerned?). In fact,

⁹¹ Although the guidelines compliance tables still literally state which competent authorities of which Member States comply, intend to comply or do not comply with ESMA's guidelines by indicating a 'Yes' in green or a 'No' in red. See van Rijsbergen, 'On the Enforceability of EU Agencies' Soft Law at the National Level' (n 2).

⁹² ESA Regulations, as amended by ESA Amendment.

it does not even require the Commission to provide a reasoned response to the reasoned advice. The second question relates to how one is supposed to prove direct and individual concern in the case of guidelines and Q&As. If this is to be interpreted in line with Article 263 TFEU, the direct concern test is considered satisfied when the act in question directly affects the legal situation of the individual⁹³ and leaves no discretion to its addressees, who are entrusted with the task of implementing it.⁹⁴ Yet, how can soft law affect the legal situation of the individual, and does soft law not, considering its non-binding nature, leave discretion to the addressees on whether or not to follow up? The test of individual concern is even more difficult to satisfy. The applicant has to be a member of a 'closed category' of people, the membership of which is already formally fixed and ascertained when the act in question enters into force.⁹⁵ Carrying out a particular economic activity affected by the measure does not suffice, even where the applicant is gravely affected by the measure⁹⁶ or when, at the time the measure was enacted, the applicant was effectively one of very few – or even the only one – carrying out that activity, as long as others could decide to undertake that activity in the future (i.e. after the adoption of the act).⁹⁷ Given the fact that they are by definition addressed to all competent authorities and/or all financial market participants, this seems a very high threshold for guidelines and Q&As. The amended ESA Regulations clarify that recommendations may be issued to one or more competent authorities or to one or more financial market participants. Hence, it may be easier to satisfy the test of individual concern in relation to recommendations.

⁹³ Joined Cases 41 to 44/70 *NV International Fruit Company and others v Commission* EU:C:1971:53, paras 23–28.

⁹⁴ Case 294/83 *Parti écologiste "Les Verts" v European Parliament* EU:C:1986:166.

⁹⁵ Case 25/62 *Plaumann & Co v Commission* EU:C:1963:17.

⁹⁶ Case T-173/98 *Agricultores Unión de Pequeños Agricultores v Council* EU:T:1999:296,

⁹⁷ See e.g. Case 1/64 *Glucoseries réunies v Commission* EU:C:1964:57; Case C-290/94 *P Buralux SA, Satrod SA and Ourry SA v Council* EU:C:1996:54, paras 28–29.

VI. CONCLUSION

This article investigated the legitimacy of the legal framework surrounding ESMA's new soft law powers. It distinguished between input, output and throughput legitimacy. Input legitimacy requires *ex ante* participation in the decision-making process either directly by citizens or indirectly via representation through elected delegates. Throughput legitimacy involves a number of factors, including the transparency of EU governance processes, the quality and quantity of inclusiveness, and the openness of the EU's various institutional bodies to 'civil society'. Throughput legitimacy problems have been solved particularly with regard to the ESAs' opinions and Q&As. Union institutions or the Board of Supervisors may now require the Authorities to publicly consult stakeholders when elaborating this type of legal instrument. However, a new throughput legitimacy puzzle that has been created relates to involving industry in the process. This is the risk of 'regulatory capture', a risk that should be mitigated because it hampers the ESAs independence duties which imply that they have to be free from both political, industry and national interests.

The above analysis also shows the input legitimacy puzzle of the Commission's and ESAs' competences getting more and more entangled. On the one hand, the Commission gets more influence in the ESAs' Q&A process, because it is explicitly enabled to answer stakeholders questions submitted to the ESAs where they concern the interpretation of Union law. On the other hand, the ESAs obtain a right of initiative, under specific circumstances, within the traditional sphere of competence of the Commission: the ESAs can use their 'no-action letter' power to ask for a change in level one or two texts. However, the ESAs expertise also has the ability to enhance the quality of EU legislation and to better meet the goals which the rules aim to achieve.

An output legitimacy puzzle lies in the fact that the ESAs are EU agencies, meaning that they need to be able to act independently. The Commission should therefore give the ESAs enough freedom and not overly interfere

with all the Authorities' soft law activities. At the same time, the ESAs should not be unaccountable. Indeed, as we have seen, output legitimacy refers to satisfactory regulatory outcomes and requires the prevention of abuse of political power by holding a regulator accountable for its decisions *ex post*. In the case of the ESAs this is arranged by means of enhanced accountability mechanisms – varying from simple reporting obligations to the possibility of launching full scale parliamentary investigations – and the possibility for natural and legal persons to send a letter to the Commission when they are of the view that the ESA in question has exceeded its competence when issuing guidelines, recommendations or Q&As. The danger is that the latter becomes a dead letter given the difficulties for a legal or natural person to prove its individual and direct concern of a soft law act.

Overall, the new ESA Regulations have given the Authorities both new powers and new ways to be held accountable. Not only do the new powers come with procedural constraints, but the management of the ESAs can be held accountable by the European Parliament and by the public. This article explained the improvements made to the legitimacy of the ESAs soft law powers as a result of the ESA review, while also pointing at a number of new legitimacy puzzles that the review has created. It remains to be seen how the ESAs will use their newly acquired powers and how the new checks and balances will operate in practice over the coming years.