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A Capital Markets Union for Europe: Legal Issues and a 29th Regime

By Alexandria Carr

The Commission will publish an Action Plan setting out its key priorities on Capital Markets Union ("CMU") in September 2015. This article considers the legal challenges the Commission faces in attempting to achieve its ambitious objective of creating a liquid, transparent, integrated and well–regulated single capital market by 2019. In particular, it argues against the adoption of new legislation to achieve the Commission's objective.

The case against new EU legislation

When considering the reasons for the fragmented capital markets in the European Union ("EU"), the Commission identified divergent national laws in areas including taxation, insolvency, company law, securities law, market rules, market access, investor/ consumer protection, contract law, conflict of law rules and recovery and resolution for non-banks entities. The finding is not new and reflects in part the 2001 findings of an expert group set up to advise on financial market issues (The First Report of the Giovannini Group (2001): "Cross-border clearing and settlement arrangements in the European Union"). Detailed consideration of the attempts made to tackle the Giovannini barriers is beyond the scope of this article but the short point is that several of the barriers identified by the group remain and resurface in the Commission's green paper.

The problems caused by divergent national laws is thus well-established but that does not necessarily mean that new EU-level legislation is the solution. Indeed, there are a number of legal reasons which would render such EU legislation problematic. These include the following:

- The EU can only operate within the competencies conferred on it. Article 5(2) of the Treaty on the Functioning of the European Union ("TFEU") provides that: "Under the principle of conferral, the Union shall act within the limits of the powers conferred upon it by the Member States in the Treaties to attain the objectives therein." Thus if a competence is not conferred on the EU, Member States retain their national competence. Broadly speaking, matters such as direct taxation, substantive insolvency law and private law matters remain primarily a matter of national competence, although the EU can regulate those elements which, for example, create obstacles to trade in the internal market or relate to consumer protection. For example, Article 50 TFEU, which is concerned with freedom of establishment, enables the EU to harmonise various aspects of company law; Articles 114 and 115 have been used to regulate elements of private law, such as taxation and contract law, which create obstacles to trade in the internal market; and Article 352 allows the Council to act by unanimity in areas not specifically foreseen under the Treaties but which are within the framework of the policies set out in the Treaties.

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- The internal market and consumer protection are 'shared competences', meaning that Member States as well as the EU can pass legislation in these areas, provided domestic legislation does not contradict EU legislation and the EU has not 'occupied the field' so that there is no further room for domestic action in the particular area. Where the EU acts it must do so in compliance with the principles of subsidiarity and proportionality which mean respectively that: the objectives of the proposed action cannot be sufficiently achieved by the Member States acting on their own and they can, therefore, be better achieved by action on the part of the EU; and EU action must not exceed what is necessary to achieve its objectives.
- Despite the creation of a single rulebook in financial services regulation and the increasing tendency to use regulations as opposed to directives, differences even in the implementation of EU law remains. Some directives remain in force and new directives are still adopted. The result is that where directives are in use there will be inevitable differences between Member States. This may be because the directives deliberately grant Member States a discretion, because they permit gold-plating (when implementation goes beyond the minimum necessary to comply with a directive) or simply because the form and method of implementing a directive is up to each Member State.

In addition to different laws, there are also different regulatory and supervisory practices throughout the EU. Based upon the principles of subsidiarity and proportionality, the EU has traditionally had responsibility for financial services regulation but deferred to Member States as regards operational supervision and enforcement: in practice, there has been a distinction between the centralised making and the local application of rules. Member States have often provided their national regulators largely discretionary powers to supervise financial institutions and enforce the law. This has permitted different regulatory responses within different Member States which persist despite the giant steps towards closer integration that have been taken since the financial crisis.

Given the above, the Commission's attempts to find non-legislative solutions to deal with the underlying reasons for the fragmentation of national markets is sensible. Market-led initiatives, for example, can be efficacious. The US private placement market is almost three times bigger than that in the EU and a significant catalyst for its growth was the development of standard forms approximately 20 years ago. Similar steps are starting to be taken in the EU.

A 29th regime?

The Commission has questioned whether the introduction of a standardised product in two areas would contribute towards the development of CMU: pensions and securitisations. Such a suggestion raises significant legal issues.

The nature of pension provision is generally a national competence. The Commission notes that the providers of personal pensions are subject to a number of different pieces of EU legislation and this is why it questions whether the introduction of a standardised product, for example through a pan-European or 29th regime, should be created. For similar reasons, the Commission also suggests the creation of an optional EU securitisation structure. Creating a harmonised EU securitisation structure is as an ambitious concept as creating an additional personal pensions regime as it would involve changes or additions to company law, insolvency law and other areas currently covered by Member States' national laws.

A 29th regime is not a new suggestion but it is controversial. The hypothesis is that a new body of law is enacted at EU level which creates an optional uniform European system as an alternative to either divergent or harmonised national regimes. The 29th regime does not replace existing national level rules but offers a choice: those affected can decide whether the 29th regime or their domestic body of law should govern their legal relations.

The idea of a 29th regime that introduces a new body of law and does not harmonise, modify or substitute the existing national raises fundamental questions of competence, subsidiarity and proportionality. Difficult practical and political issues would also arise, including whether such a regime should be modelled primarily on the more commercially popular common law approach or on the civil law approach with which most EU citizens are familiar. The question of how to ensure that individuals who have to choose which body of law should apply to them are sufficiently informed and protected would have to be addressed.

The Commission's objectives are clearly laudable but how they can be achieved is less clear. If, as this article contends, a legislative solution is not ideal, what alternatives can effectively bring about a single capital market in a timely manner? We may have to wait until September to find out.

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