The European Union in International Financial Governance

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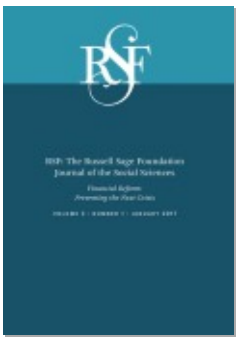

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The European Union in International Financial Governance

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This article considers the role of the European Union in international financial governance after the institutional reforms it undertook in connection with the global financial crisis. It suggests that the new administrative actors that support the governance of the European Union's single financial market, notably the European Supervisory Authorities, have the potential to reshape how the European Union engages with international financial governance. It finds that the European Union's effectiveness in influencing international financial governance—and the effectiveness of international financial governance more generally—is likely to strengthen as a result.

Keywords: European Supervisory Authorities, international financial governance

This article considers how the role of the European Union (EU) in international financial governance—regarded as the complex of standards, market access arrangements, and coordination structures that support the global financial market—is changing, the drivers of this change, and the implications. Specifically, it considers how the EU's new supranational administrative structures, which support the governance of the EU's single financial market (the European Supervisory Authorities, or ESAs), may affect change. The single financial market is composed of the national markets of the EU's twenty-eight member states, which are subject to common, harmonized regulation under the EU's "single rule book;" the single rule book also supports liberalized cross-border access by financial actors in one member state of the EU to the markets of other member states. The European Supervisory Authorities were constructed during the global financial crisis era in order to support the financial stability of the single financial market. But they also have the potential to reshape how the EU engages with the institutions of international financial governance, notably the major international standard setters: the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (Basel Committee), and the International Organization of Securities Commissions (IOSCO). The article also suggests that the ESAs are likely to reinforce the effectiveness of international financial governance more generally. By drawing on empirical observation of the new ESAs, and on a composite legal and international political economy literature, the article seeks to contribute to understanding of how administrative ac-

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tors interact with and influence international financial governance.

THE EUROPEAN UNION AND THE CHANGING NATURE OF INTERNATIONAL FINANCIAL GOVERNANCE

The EU has long been a significant actor in international financial governance. Prior to the global financial crisis the EU was increasingly imposing its preferences on international financial governance and, in particular, on standard setting and application of standards (Posner 2009). The 2002 adoption by the EU of the International Financial Reporting Standards (IFRS) issued by the IFRS Foundation as the internal financial reporting standard for EU listed companies, for example, became associated with a weakening of the global dominance of the United States' Generally Accepted Accounting Principles (GAAP). This change reflected in part the imposition by the EU of IFRS-equivalence obligations on third-country firms seeking access to the EU financial market (Moloney 2014a, 165–68). Over the global financial crisis reform period (broadly, 2008 to 2014) the EU, sometimes as a loose coalition of member states acting intergovernmentally and sometimes as a more cohesive, supranationally oriented regional bloc, became a significant force in the Basel Committee and in IOSCO as new standards were adopted for the global financial market (Quaglia 2014a). To take another example, EU-U.S. clashes on the over-the-counter (OTC) derivatives market reforms adopted to address the financial stability risks exposed by the global financial crisis became a major preoccupation of international financial diplomacy over the crisis period (Moloney 2014a, 615–20). The extent to which the EU has been able to impose its distinct, collective preferences on international standard setting over the global financial crisis period has been well documented (Blom 2014; Quaglia 2014a). While EU member state preferences have remained of determinative importance during this period, the period can also be associated with the EU's increasingly acting as a hegemonic great power in finance, imposing its political preferences on international standard setting (Mügge 2014). The nature of international financial governance and of the forces playing upon it is changing, however, and reconsideration of the EU's role is accordingly necessary.

The nature of international financial governance is shifting. It has previously been primarily preoccupied with the agreement and adoption of standards governing the international financial system. It is now pivoting to address in addition the achievement of the outcomes sought by standards. It is accordingly engaging more closely with standard implementation and with the management of related divergences, operational supervisory coordination and convergence, data collection and assessment, the coordination of enforcement, and regulatory learning and sharing of best practices (Helleiner and Pagliari 2011). Post-crisis international financial governance has similarly been characterized as representing a form of "mutual adaptation" and "cooperative development" (Helleiner and Pagliari 2011). Accordingly, the operational management of divergence and friction in standard implementation, the coordination of supervisory approaches, and mutual regulatory and supervisory learning—rather than the imposition of political preferences on international standard setting—is coming to characterize the dynamics of international financial governance.

For example, international standard setters are increasingly focusing on implementation of standards, the achievement and benchmarking of related required outcomes, and the risks associated with escape from and divergences in standard implementation. The FSB continues to report to the G-20 on progress on implementation of the crisis-era reforms and is undertaking regular and intensive peer reviews of how crisis-era standards are being implemented (Financial Stability Board 2015a). The Basel Committee is carrying out intensive Regulatory Compliance Assessment Programs (RCAPs) of Basel III Accord implementation. Supervisory co-ordination arrangements are being constructed, with attention being trained in particular on co-ordination through colleges of supervisors (Basel Committee on Banking Supervision 2014a; International Organization of Securities Commissions 2013). IOSCO has recently engaged in an intensive review of the range of regulatory tools which can

be deployed to support supervisory coordination in the securities markets (International Organization of Securities Commissions 2015a) and has also addressed enforcement, highlighting the tools that should be available to regulators globally (International Organization of Securities Commissions 2015b). The international standard setters are also increasingly focusing their attention on the management, interrogation, and deployment of the massive dataset now emerging for regulatory use, in the wake of the crisis-era reforms, which mandate more intense reporting from a number of market segments, notably the OTC derivatives market (Financial Stability Board 2015b). On a bilateral basis, granular agency contacts are intensifying as the technical details governing third-country market access and reflecting the swathes of new rules imposed domestically and regionally following the global financial crisis are negotiated and coordinated.

Coordinated and optimal operational management of technical difference, supervisory cooperation, the interrogation of complex data, and the sharing of technical regulatory and supervisory experience has accordingly become of central importance to international financial governance. And as international financial governance becomes more outcomes-focused and operational, the administrative actors in international financial governance, primarily the regulators who sit (often alongside treasuries and central banks) on the international standard setters, are, in parallel, acquiring critical importance. How, accordingly, is the EU, which has long engaged with international financial governance by means of imposing national member state and collective EU preferences on standard setting, equipped to engage with a more operational form of governance; and what are the implications for international financial governance and, specifically, for the international standard setters? Will the new administrative apparatus that supports EU financial governance, and specifically the ESAs, provide a means for effective engagement with this changed environment? And how should these questions be situated within the literature?

INTERNATIONAL FINANCIAL GOVERNANCE AND THE EU: SCOPING THE LITERATURE

In assessing the role of the European Supervisory Authorities in providing a new administrative channel through which the EU influences international financial governance, this article seeks to contribute to the composite but rich literature on international financial governance. An influential strand of legal scholarship has recently examined the nature of international financial governance with respect to its effectiveness and to how it achieves outcomes, including through institutional design and legal mechanisms. Drawing on the network theory of international law (Slaughter 2004), this strand explains how and why international financial governance, though primarily based on soft law and on informal networks of regulators operating through the international standard setters, can exercise coercive force (Brummer 2012). In the wake of the global financial crisis this scholarship is increasingly considering the lack of resilience of the structures and products of international financial governance in the face of global systemic risks and intense political intervention (Verdier 2013).

A related body of legal scholarship, which builds on the Global Administrative Law analysis (Krisch and Kingsbury 2006), probes the accountability and legitimacy risks that flow from the soft-law- and network-based nature of international financial governance (Barr 2014). This composite legal literature supports critique of the ESAs as administrative actors in international financial governance given, in particular, their limited coercive ability (discussed further in a later section). But the cognate literature on international political economy provides additional tools of analysis as it examines the power dynamics of how different actors engage with and influence international financial governance and thus can support examination of the context in which the ESAs operate.

An important segment of the international political economy literature probes how different actors and their preferences shape international financial governance. It has traditionally

characterized international financial governance as being shaped by the preferences of the "great powers" in finance, classically the United States but increasingly the EU (Drezner 2007; Mügge 2014). But it also probes how "great power" preferences are formed and, with particular relevance for the role of the ESAs in international financial governance, the role of administrative actors (domestic regulators) in shaping and diffusing great power preferences by supporting the "regulatory capacity" of the state: the state's ability to achieve outcomes through the adoption, monitoring, and implementation of rules (Bach and Newman 2007). In particular, the extent of a state's regulatory capacity can be associated with the strength of its ability to influence international financial governance (Newman and Posner 2015) by, for example, imposing third-country access requirements or by diffusing, through technocratically expert national regulators, preferences to the international standard-setting level (Büthe and Mattli 2011). In the EU, distinct member state preferences (which typically diverge to some extent with respect to international standard setting, reflecting the different institutional economic models that characterize the EU's member states; preferences will tend to converge where the distributional effects of international standards are weak), rather than the preferences of the EU as a notional global "great power" in finance, have until recently been the dominant influence on EU engagement with international financial governance (Quaglia 2014a).[1] But the regulatory capacity of the EU, notably with respect to the extent to which the EU can, through its internal legislative and administrative apparatus, shape and implement (and thereby signal the credibility of) international standards and, by means of third-country access rules, impose its preferences on other jurisdictions, has been identified as an increasingly important factor and as strengthening the influence of the EU as a collective actor in international financial governance (Posner 2010; Bach and Newman 2014). Similarly, the EU's regulatory capacity can dictate the extent to which it can delegate to a representative EU actor, typically the European Commission (the EU's supranational executive body), and so through delegation pull the member state principals toward a stronger collective position in the international standard setters (Quaglia 2014a; Mügge 2011).

The nature of the EU's engagement with international financial governance is increasingly receiving attention in EU legal scholarship, particularly in the wake of the global financial crisis and the related framing of the EU reform agenda within the G-20 reform agenda, and given the lessons which the EU's experience in designing legal solutions to cross-border co-ordination problems may hold for the international financial system (Ferran 2014; Amtenbrick 2013). But the ESAs, as new EU administrative actors in international financial governance, have not been examined closely by either the legal or international political economy literature. Legal analysis thus far has primarily focused on the new ESAs' place within the EU's constitutional order and on their impact on institutional governance for the EU financial system (Moloney 2014b, 854–1009; Busuioc 2013; Schammo 2011). International political economy analysis has focused primarily on the member states and on the EU institutions, which are established under the EU Treaties (primarily the European Commission) and through which the member states operate at international level (Quaglia 2014a; Mügge 2014). But legal analysis of the ESAs' powers and their related incentives with respect to international engagement, together with the regulatory capacity insights of international political economy, have potential powerful explanatory force with respect to how the EU's engagement with international financial governance may change. Accordingly, this analysis draws on the composite literature out-

1. The EU financial market is second only to the U.S. market in size. Recent analysis by the European Commission notes that as of the end of 2013, EU stock market capitalization stood at €8.4 trillion, 64.5 percent of GDP, and the value of outstanding debt securities was €22.3 trillion, 171.3 percent of GDP. See European Commission 2015a, 10–11.

lined to examine how the ESAs may reshape, through administrative means, how the EU engages with and influences international financial governance.

THE MEMBER STATES AND THEIR PREFERENCES IN INTERNATIONAL FINANCIAL GOVERNANCE

The arrival of the ESAs has led to the construction of a new administrative channel for engagement with international financial governance in the EU. The member states and their preferences have long been the dominant influence on the EU's international financial diplomacy at the international standard setters. International financial relations, notwithstanding the recent changes to institutional governance in the EU and the establishment of the ESAs, remain primarily within the control of the member states and, to a lesser extent, the European Commission (EC, the major EU institution to which collective EU representation is delegated) and, depending on the regulatory issue in question, the European Central Bank (ECB). Although a highly detailed, harmonized single rule book applies to the EU financial system in the wake of the global financial crisis, coordination in the international standard setters can still be loose; the member states and their distinct interests often drive international engagement, and the extent to which the collective EU interest is formally represented and has voting power varies. As discussed in subsequent sections, the ESAs are likely to reshape this allocation of competence and in so doing to strengthen EU engagement with the current and more operational phase of international financial governance.

The EC typically represents the supranational, collective EU interest (where one can be identified, given that the distributional effects of financial regulation are felt differently across the different economies and market structures of the member states). In the Financial Stability Board, for example, the EC, along with the ECB, is a member of the thirty-four-member decisionmaking plenary session along with the U.K., France, Germany, Italy, the Netherlands, and Spain, which are represented by their finance ministries, central banks, or other regulator. In the Basel Committee, the ECB as monetary authority and the ECB as bank supervisor sit along with central banks and national bank regulators from Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden, and the U.K. as full voting members; the EC is represented but has only nonvoting observer status (Quaglia 2014a, 2015). Similarly, on IOSCO the EC has associate member (nonvoting) status while the national securities regulators of the member states are ordinary voting members of IOSCO. Six EU regulators are permanent members of the thirty-three-member IOSCO decisionmaking body (Conac 2015). Member states are, accordingly, usually independently represented and coordination can be limited. Levels of coordination have varied over time: a high degree of EU coordination can be observed with respect to discussions with the IFRS Foundation, but low levels with respect to IOSCO discussions, reflecting the different interests and incentives engaged in each case (Quaglia 2014b). Similarly the degree of coordination of national and EU positions on the Basel Committee has been mixed, reflecting in particular persistent divergences across member states' banking markets (Quaglia 2015).

A more decentralized model applies with respect to other forms of international engagement beyond participation in the international standard setters, including the negotiation and adoption of supervisory coordination and exchange arrangements by member states (Moloney 2014a). Since the establishment in 2011 of the ESAs, however, the institutional dynamics, incentives, and preferences in play have been changing. The crisis-era reconstruction of institutional governance for the EU financial system was designed to address internal EU challenges with respect to pan-EU risk transmission and the mutualization of supervisory risks and costs. But there have been spill-over effects, notably with respect to the potential role of the ESAs in international financial governance, with respect to the regulatory capacity of the EU, and thus with respect to the different incentives and preferences that shape EU engagement internationally.

THE EUROPEAN SUPERVISORY AUTHORITIES: A NEW ADMINISTRATIVE GOVERNANCE STRUCTURE FOR THE EU

The ESAs represent a new form of administrative governance for the EU single financial market (Moloney 2010, 2013). Prior to their construction, the supervision of the single financial market was for the most part located at national level (although coordination arrangements linking "home" and "host" member state regulators applied), and the EU's capacity to adopt technical administrative rules was limited (Ferran 2012). A significant degree of institutional centralization followed the global financial crisis, which led to a rearrangement of EU-level regulatory and supervisory governance in order to address the catastrophic leakage of risk cross-border in the EU and to support financial stability (Moloney 2014b; Ferran 2012). The ESAs form part of the new European System of Financial Supervision, which was established in 2011 to strengthen the EU's regulatory and supervisory governance and, hence, the EU's ability to contain and manage systemic risk and to support the financial stability of single market. The European System of Financial Supervision is, very broadly, a decentralized institutional arrangement for coordinating supervision and for supporting technical rulemaking for the EU financial system (legislative rulemaking is the prerogative of the EU's Treaty institutions: the EC, which proposes rules; the Council, which represents the Member States and is a co-legislator; and the European Parliament, which represents the citizenry and is a co-legislator). The European System of Financial Supervision is composed of the member states' national regulators, who provide the foundations of the system and are responsible for supervision and enforcement; three sectoral ESAs, which are conferred with an array of quasi-regulatory and supervisory powers (the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority); and the European Systemic Risk Board, which is responsible for monitoring pan-EU systemic risks.

The ESAs take the form of independent administrative agencies, funded by a combination of member state and EU funds, and have been established under primary EU legislation adopted by the Council and the European Parliament. Consequently they are not treaty institutions, unlike the EC and the ECB. Decisionmaking is carried out by their respective boards of supervisors, which are composed of the relevant national regulators of the twenty-eight member states. With respect to regulatory governance, the ESAs support administrative rule making by the EC (the constitutional location of administrative rulemaking for the EU under the EU Treaties) by proposing technical rules and by providing expert advice. The ESAs are also empowered to adopt soft law, primarily in the form of "Guidance" with which national regulators must "comply or explain."

Although supervision remains at national level, the ESAs have been given a range of coordination and convergence powers, including data collection, peer review, and participation (on a nonvoting basis) in the different colleges of supervisors required under the EU's harmonized single rule book for financial services. The ESAs can also deploy a very limited suite of direct intervention powers—limited because of the strength of member states' hostility to the ESAs' having powers that could carry fiscal risks for national treasuries. The ESAs can impose decisions on national regulators in three exceptional situations, and subject to detailed conditionality in each case: where the national regulator is in breach of EU law, in emergency conditions, and following a binding mediation by an authority between national regulators. The European Securities and Market Authority has an additional suite of direct powers—reflecting political priorities and conditions as well as the limited fiscal risks posed to the member states by these powers The European Securities and Markets Authority has exclusive supervisory and enforcement authority over credit-rating agencies and the trade repositories that hold OTC derivatives market data (the authority has displaced the national regulators in these areas); specified and exceptional powers to intervene to prohibit short selling in a member state or pan-EU; and specified and exceptional powers relat-

ing to prohibiting products and to holding positions in commodity derivative markets in a member state or pan-EU.

Alongside the coordination-oriented EU structures of the single-market-based European System of Financial Supervision are the distinct EU structures that support Banking Union. Banking Union applies to member states that are in the euro area—the Economic and Monetary Union—on a mandatory basis and to other EU member states on a voluntary basis. Banking Union is also institution-specific: with some very minor exceptions relating to group structures it governs only deposit-taking institutions within these member states. Banking Union, a primarily euro-area construct, is distinct from the wider single-market-oriented European System of Financial Supervision. Banking Union is operational, executive, and risk-mutualizing in character; it is not a coordination device, as is the European System of Financial Supervision. Banking Union is designed to address the "toxic feedback loop" which developed over the financial crisis in the EU (relating to the nexus between fragility in the euro-area banking system and the wider sustainability of euro-area member states' fiscal positions and, ultimately, of the euro) by providing for risk mutualization and for pooled support to the euro-area banking system (Moloney 2014b; Ferran 2015a).

Banking Union's Single Supervisory Mechanism brings the supervision of some six thousand banks, directly and indirectly, under the oversight of the ECB. A treaty institution and the EU's monetary authority, now the ECB is a banking supervisory authority. The Single Supervisory Mechanism is concerned with bank authorization, "steady state" bank supervision, and early intervention; it operates under the EU's harmonized single banking rule book for the single market. The ECB is responsible for the functioning of the Single Supervisory Mechanism; has direct supervisory authority over 129 of Banking Union's largest and most systemically significant banks; and has oversight authority (which it exercises by means of rules, guidance, and supervisory protocols, as well as by means of its deterrent power to take over supervision) over the remainder of Banking Union's banks, which are supervised directly by their national banking regulators within the Single Supervisory Mechanism. The Single Resolution Mechanism brings the resolution of Banking Union banks within the control of a new agency called the Single Resolution Board and includes a Single Resolution Fund to support resolution. The Single Resolution Mechanism operates within the EU's harmonized single bank resolution rule book. Both the ECB (within the Single Supervisory Mechanism) and the Single Resolution Board (within the Single Resolution Mechanism) are subject to the ESAs' powers.

THE EUROPEAN SUPERVISORY AUTHORITIES: A NEW ADMINISTRATIVE CHANNEL FOR ENGAGEMENT WITH INTERNATIONAL FINANCIAL GOVERNANCE

Although their primary function is to support the stability and efficiency of the EU single financial market, under their founding EU regulations the ESAs have been given the power to develop contacts and enter into administrative arrangement with international bodies.[2] But the ESAs must use their powers without prejudice to the respective competences of the member states and the EU institutions, so formally the ESAs' representation functions are limited. The more detailed administrative powers with respect to international financial governance conferred on the ESAs in specific EU measures governing particular aspects of the EU financial system relate, for the most part, to supervisory cooperation and coordination, including the facilitation of information exchange and cooperation agreements between member state regulators and third-country regulators.[3] Specific EU measures have also conferred on the ESAs a range of powers relating to the

2. For example, Regulation (EU) No. 1093/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Banking Authority) OJ (2010) L331/12, Article 33.

3. Such as, for example, the major EU market regulation measures: Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and

equivalence-based, third-country market-access requirements that apply to third-country actors seeking to access the EU financial market. The ESAs are usually empowered to advise the EC on whether a third-country legal regime is equivalent to the EU regime. This limited suite of formal powers does not reflect the extent to which the ESAs can extend their regulatory capacity and that of the EU with respect to international financial governance and thereby construct a new administrative channel for international financial governance. A case study of the European Banking Authority, based on empirical observation of its recent activities, is noted in a later section.

Although the three ESAs have distinct incentives and preferences when it comes to international engagement, reflecting their different operating environments, they have others in common. In particular, the ESAs are new administrative actors in EU financial governance, are of ambiguous status, operate in complex institutional environments, and are developing under the "shadow of hierarchy" (Héritier and Lehmkuhl 2008). Although constituted as independent regulatory agencies, the ESAs have little in common with domestic regulators worldwide. They operate under tightly confined mandates and with limited operating powers. This constrained operating environment reflects, politically, the member states' wariness in ceding powers which may lead to incursions into national sovereignty and to fiscal risks, as well as the significant EU Treaty limitations which apply to the construction of EU agencies. The treaty competence that has been used as the basis for the construction of the ESAs (Treaty on the Functioning of the EU, Article 114) remains contested, for example, because of doubts that the competence, which is directed to the approximation of rules for the support for the single market, can be stretched to include institution building. Although the Court of Justice of the EU provided some assurance as to the resilience of the relevant competence in 2014, albeit only with respect to specific authority powers and not with respect to their foundation and their powers more generally,[4] doubts remain given the narrow focus of the Court's ruling. EU constitutional arrangements also prevent the ESAs from being conferred with wide-ranging discretionary powers, in order to protect the institutional balance set up under the treaties between the member states, the EC, the Council, and the European Parliament; strict conditionality accordingly applies to their operation, including with respect to their limited supervisory powers.[5] Similarly, under the EU Treaties the EC is the location of administrative rule making. The ESAs may only propose and advise on administrative rules, and their proposals and advice can be vetoed by the EC, even where extensive market consultation and impact assessment has been undertaken by the ESAs. Finally, the EC represents the EU in trade- and single-market-related matters (Treaty on the Functioning of the European Union, Article 220). The shadow of EC hierarchy accordingly blankets the ESAs. The European Parliament also casts a long shadow. It has long been careful to protect its (limited) prerogatives with respect to administrative rulemaking, in relation to which it, along with the Council, can veto EC rules. It has recently shown some concern to exercise tighter control over the ESAs, including by calling for the European Parliament to have access to internal ESA deliberations on the drafts of the proposals for and advice on administrative rules that the ESAs must deliver to the EC (European Parliament Economic and Monetary Affairs Committee 2015). The operating environment is particularly complex for the European Banking Authority, as it operates under the lengthy and expanding shadow of the ECB within Banking

Directive 2011/61/EU (2014) OJ L173/349 (MiFID II); and Regulation (EU) No. 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No. 648/2012 (2014) OJ L173/84 (MiFIR). These measures confer power on the European Securities and Markets Authority with respect to international cooperation and coordination in relation to the matters within their scope.

4. *UK v. Council and Parliament*, Case C-270/12, January 22, 2014.

5. *Meroni v. High Authority*, Case 9/56 (1957–1958) ECR 133.

Union and is facing something of an existential threat (Ferran 2015b).

With this complex and constrained operating environment, the ESAs—as new administrative actors seeking to embed their position within EU financial governance— have considerable incentives to strengthen and assert their institutional position and regulatory capacity, and to reinforce their primacy as technocratic and independent agencies, while respecting the EU Treaties' limits on their powers. International financial governance is likely, accordingly, to have significant appeal for the ESAs. The soft law nature of international financial governance means that engagement with the international standard setters affords the ESAs the opportunity to strengthen their capacity and institutional position with a degree of freedom. As international financial governance and the international standard setters pivot to a more operational orientation, they provide a natural channel through which the ESAs—whose functions and powers are directed to pan-EU coordination and who have a unique set of experiences on how cross-border and regional coordination risks can be managed—can strengthen their capacity and credibility. For example, the European Securities and Markets Authority is becoming increasingly sophisticated in how it approaches the peer review of its member regulators (which is required of it under its founding regulation), having recently upgraded its peer review mechanism and adopted a more robust and granular approach to peer review.[6] It is also increasingly focusing on supporting supervisory coordination and supervisory convergence across its national regulators (European Securities and Markets Authority 2015). Given its practical experience in managing the coordination risks associated with the supervision of securities markets, the European Securities and Markets Authority, although a nonvoting member of IOSCO, can be expected to acquire credibility and capacity and seek influence within IOSCO. As an indication of the movement within international financial governance to operational matters, IOSCO is now subject to requests from the FSB to carry out peer reviews.[7] The opportunities for the European Securities and Markets Authority to strengthen its credibility on IOSCO may therefore be significant, given its extensive experience in this area and given the initial indications that its influence may become significant, if still developing (Conac 2015).

Despite this potential, there are limitations on how much the ESAs can, through international engagement, extend their regulatory capacity and thus the influence of the EU on international financial governance. The structures of national economies across the EU continue to diverge significantly (European Commission 2015a), as is reflected in the EU's current efforts to build a European Capital Markets Union (European Commission 2015b). Accordingly, the national regulators, which, through the different Boards of Supervisors, determine ESA decisionmaking, will often have strong incentives to follow a national rather than a collective position. On the other hand, as international financial governance pivots toward operational coordination and away from standard setting (where distributive effects are likely to be stronger), the opportunities for strong national interests to obstruct European Supervisory Authority decisionmaking may recede. But the ESAs must also often operate in a muddy international environment. The EC, and often the ECB, can also represent the EU interest and they have strong incentives to protect their respective positions. There are, however, indications that the ESAs will intensify their activities in international financial governance—given the potential such activities hold for influence and capacity build-

6. On peer review of member regulators with respect to the supervision of best execution see, for example, European Securities and Markets Authority, "Best Execution Under MiFiD: Peer Review," 2015, www.esma.europa.eu/sites/default/files/library/2015/11/2015-494_peer_review_report_on_best_execution_under_mifid_0.pdf; accessed June 10, 2016.

7. See, for example, International Organization of Securities Commissions, "Peer Review of Implementation of Incentive Alignment Recommendations for Securitization," 2014, www.iosco.org/library/pubdocs/pdf/IOSCOPD504.pdf; accessed December, 15, 2015, which followed a request from the FSB.

ing, with a consequent strengthening of both the EU's ability to influence the international standard setters and the resilience of the international standard-setting process, as is discussed further below with respect to the European Banking Authority.

THE EUROPEAN BANKING AUTHORITY: A CASE STUDY

The European Banking Authority has an express general mandate to enter into coordination arrangements and information-exchange agreements with third-country regulators and international standard setters (2010 European Banking Authority Regulation, Article 33). The EU's major harmonized banking regulation measure confers additional administrative powers on the authority,[8] including supporting international coordination and advising the EC on equivalence-related and EU market-access matters. The authority also sits as a nonvoting observer on the Basel Committee, alongside the EC (nonvoting observer), the ECB (voting member), and relevant national regulators and central banks within the EU (voting members).

The fragility of the authority's institutional operating environment gives it significant incentives to engage with international finance governance through formal and informal means. This fragility is a function of the fragmentation between the single market in banking (the remit of the authority's coordination and quasi-regulatory powers) and the euro-area Single Supervisory Mechanism (the remit of the ECB). This fragility generates a number of threats for the authority (Moloney 2014b; Ferran 2015a). Its quasi-rulemaking powers over the single market are threatened by the risk of Single Supervisory Mechanism caucusing with the relevant regulators on the authority's board of supervisors (nineteen of the authority's twenty-eight national regulators are members of the Single Supervisory Mechanism), which could reduce its effectiveness; and also by the emergence of the ECB as a potentially competing standard setter, albeit within the Single Supervisory Mechanism "zone," as the ECB is empowered to adopt rules, guidance, and other protocols for the Single Supervisory Mechanism.

Efforts have been made to address these risks, including through governance reforms (a double-lock procedure applies to authority voting in that decisions must be carried by a majority of Single Supervisory Mechanism authority members and also by a majority of non–Single Supervisory Mechanism members of the authority); and a requirement for the ECB to follow the authority's soft law and other measures. But the risks to the authority's capacity remain considerable, particularly as euro-area membership (and accordingly Single Supervisory Mechanism membership) will grow from the current nineteen (of twenty-eight) EU member states to, over time, twenty-six. Similar risks arise with respect to supervisory governance. The ECB, under the EU regulation that confers on it supervisory power over the Single Supervisory Mechanism, is subject to the authority's soft and hard coordinating powers. But whether or not the authority, a nascent agency established under EU primary legislation and with significant operating constraints, can (and has the incentives to) exert authority over the mighty ECB, which has direct executive supervisory powers over the 129 largest banking groups in the euro area and which enjoys the independence of action of a treaty institution, remains to be seen.

The authority has accordingly significant incentives to seek international financial governance, and in particular Basel Committee deliberations, as a sphere in which it can boost its credibility and regulatory capacity and protect its institutional position. The capacity of

8. This regulation is the 2014 Capital Requirements Directive IV, Capital Requirements Regulation, which, inter alia, implements the Basel III Accord in the EU: Regulation (EU) No. 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No. 648/2012 (2013) OJ L176/1; and Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (2013) OJ L176/338.

the EU more generally in international financial governance for banking should accordingly be strengthened. Robust engagement with international financial governance also affords the authority the opportunity to strengthen its relationship with the ECB in a somewhat less contested forum than the EU single market, including on the Basel Committee, where both institutions are represented.

The authority is certainly well equipped to strengthen its capacity and credibility on the Basel Committee (albeit as an observer member) and to strengthen thereby the EU's position, particularly as international financial governance becomes more operational in orientation. It has deep technocratic expertise following its technical support of the construction of the administrative rules which amplify the 2014 CRD IV/CRR legislative rule book. It has valuable expertise in managing operational coordination, including of colleges of supervisors and with respect to supporting supervisory convergence (European Banking Authority 2015a, 2015b); with respect to the latter, for example, it has adopted extensive and granular Supervisory Review and Evaluation Process (SREP) Guidelines, which govern the operational business of banking supervision and amplify the Basel III Accord in the EU (European Banking Authority 2014). Its equivalence-related activities are likely to have a similar capacity-building effect, given the extensive contacts and international network the authority has developed in producing its reports on the equivalence of third-country banking regimes and on the nature of supervisory cooperation between national regulators in the EU and third-country regulators (European Banking Authority 2015c, 2015d).

The authority is also acquiring granular knowledge of the emerging divergences across the member states as to how the 2014 CRD IV/CRR regime (in effect, the Basel III Accord) is being applied (European Banking Authority 2015e), which should further enhance its credibility with the Basel Committee as the committee finesses the regime. Similarly, sitting in the center of a web of bank regulatory disclosures as the EU repository for the FINREP (financial reporting) and COREP (common reporting) reporting disclosures required of EU banks under the 2014 CRD IV/CRR regime (and accordingly under Basel III "Pillar 3"), and as the repository of EU bank stress test disclosures, further enhances the authority's technocratic capacity as the Basel Committee increasingly turns to standard implementation and review.

As against this, the authority may struggle to present a coherent collective position given the distinct interests which still drive the national regulators on its board of supervisors, reflecting the different structures of national banking markets across the EU, which may obstruct its ability to present a collective position. Conflicts of interest may arise between the authority and the EC (also an observer), while the authority must also coordinate with the ECB, which, as a direct supervisor and central bank can exercise voting power (albeit that the Basel Committee tends to operate on a consensual basis). On the other hand, divergences and conflicts are likely to be most acute with respect to standard setting. In more operational matters the authority can be expected to have a clearer space to influence and to impose a collective EU preference.

There is still only limited experience with the authority as an actor in international financial governance and against which its incentives and its growing regulatory capacity and potential as an actor internationally can be tested. But initial indications suggest a potential for growing influence by the authority (and so of the EU), particularly on more operational matters in relation to which it sits on a number of Basel Committee subgroups and working groups (European Banking Authority 2015f; Quaglia 2015). Its incentives to achieve a collective position on its board of supervisors and to seek to influence Basel Committee deliberations can be expected to increase as the ECB within the Single Supervisory Mechanism increases its power, and as the authority becomes more expert on the implementation of the Basel III Accord in the EU, particularly if banking governance internationally continues its current operationally charged trajectory.

This development is likely to strengthen international financial governance in the banking sphere. The authority has significant potential as a "legalization" mechanism (Bach

and Newman 2014), which supports the injection of soft Basel Committee standards into binding EU law through its proposal of administrative rules to the EC and which thereby signals the credibility of standards. The authority's soft law can be expected to have a similar effect. Its soft "SREP Guidelines" on how the 2014 CRD IV/CRR/Basel III regime is to be supervised in practice (European Banking Authority 2014) have considerable potential to support the diffusion of global good practice in how the Basel III SREP supervisory process should be carried out and monitored—particularly as the authority is committed to ongoing review and monitoring of the guidelines. The authority also has the capacity to act as a potential corrective agent, and thereby to support the convergent application of Basel Committee standards. International standards, as has been extensively documented, are vulnerable to being reshaped during the national implementation process in order to provide escape opportunities. In the EU the Basel III Accord has been subject to numerous exemptions and derogations in its implementation through the 2014 CRD IV/CRR regime. This led to the Basel Committee's finding, in its December 2014 Regulatory Compliance and Assessment Program review of the EU's Basel III implementation, that the EU was "materially noncompliant" with the Basel III Accord in a number of respects (Basel Committee on Banking Supervision 2014b). The authority, which given its precarious institutional position has much to gain from claiming ownership over the Basel Committee monitoring process, has been robust in warning of the risks that divergent implementation of the Basel III Accord poses and has called for corrective action from the EU's co-legislators in response to specific types of divergence. It has also suggested interim remedial action to be taken by its member regulators (European Banking Authority 2015e). The corrective function that appears to be emerging through the authority augurs well, accordingly, for the regulatory capacity of the EU at least to highlight divergences in Basel Committee standard implementation and to place pressure, accordingly, on its member states, from independent, technocratic regulators operating collectively through the authority, to take remedial action through the EU legislative process.

The authority's engagement may also have the effect of strengthening the accountability and legitimacy of Basel Committee standards, at least in the EU. The mechanisms through which the accountability and legitimacy of international financial governance are supported can be weak but are strengthening (Barr 2014). The strengthening process may be further enhanced by the changes in how the EU engages with international financial governance. Like all the ESAs, the authority is subject to an array of accountability and legitimacy mechanisms under its founding 2010 regulation.[9] These include reporting obligations to the European Parliament and Council, to whom the authority is formally accountable; the design of its board of supervisors (which includes the EC in a nonvoting capacity as well as national regulators); and the many constraints that apply to authority operation under its foundation regulation, which imposes strict conditionality on its action. Any overreaching with respect to international financial governance by the authority will likely be constrained by its board of supervisors as well as by the EC, European Parliament, and Council, particularly where redistributive effects may be significant and national and EU institutional interests are strong.

In addition, the authority, like all the ESAs, is subject to a wide range of consultation obligations under its founding 2010 regulation. These include obligations to consult widely; engage in impact assessment; provide feedback; and have a representative "Stakeholder Group" composed of industry, user, consumer, and other constituencies. In engaging with the Basel Committee the authority is accordingly subject to a range of procedural devices and operates within a constrained institutional environment, both of which should enhance the accountability and legitimacy of EU engagement with international financial governance. The authority is, for example, subject to a more restrictive set of accountability and legitimacy controls than the EC.

9. See note 2.

CONCLUSION

The management of operational risks through coordinated action by regulators is increasingly displacing standard setting as the major preoccupation of the international standard setters. Although the EU has typically engaged with international financial governance and the international standard setters primarily through its member states, and although engagement has primarily been in the form of the imposition of national and (less frequently) collective EU preferences on standard setting, it is well equipped to manage this pivot. This article suggests that the EU's European Supervisory Authorities have opened up a new administrative channel through which the EU can engage with international financial governance and the international standard setters. It predicts, from empirical observation of the recent activities of the European Banking Authority in particular and analysis of its operating environment and of the incentives it generates, that the ESAs may gain influence on the international standard setters. The EU's ability to impose its preferences, at least with respect to more operational matters, may accordingly be strengthened. This development augurs well for the effectiveness of international financial governance more generally.

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