The Divide over European Financial Regulation: an Economic and Legal Analysis of British Fears of Being Dominated by the Eurozone

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1. Introduction

THE EUROPEAN PROJECT is clearly at a crossroads. Not only do political and social developments challenge integration through 'ever closer Union' but further economic integration has been subject to very heavy criticism. As shown by the debate surrounding the UK referendum on membership in the European Union, one of the major points of contention lies in the field of financial regulation, in particular the protection of the single market.[3] One of the alleged underlying interest of the United Kingdom was to shield the City of London from increasingly burdensome regulation from Brussels, regarded as primarily serving the needs of Eurozone member states. What may be appropriate for the governance of the Eurozone was said to be a source of potential harm for the City. Reforms addressing this concern had been explicitly raised by David Cameron as an agenda item for negotiations to keep the United Kingdom in the European Union.[4]

This article seeks to determine the appropriateness of the United Kingdom's concerns and the calls for additional legal protection against the undermining

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[3] Alex Barker, 'George Osborne makes shielding City priority in EU talks', Financial Times (London, 9 September 2015).

[4] David Cameron, 'Letter to Donald Tusk: A New Settlement for the United Kingdom in a Reformed European Union' (10 November 2015) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/475679/Donald_Tusk_letter.pdf> (accessed 18 April 2016).

of the single market by Eurozone policy. Even post-Brexit, these issues remain relevant; the United Kingdom may well retain access to the single market. For this purpose, the diverging interests and concerns will first need to be defined and explained. Second, the mechanisms through which these interests may be realised will be analysed and put into the legal context. Thirdly, formal and substantive legal safeguards will be assessed against this background. Finally, we will conclude that only option to 'shield' the City is Brexit.

2. The Divide over Europe's Regulatory Integration

At the heart of the problem lies the separate existence of a currency union and a (much wider) single market. While the former is currently comprised of 19 members, the latter is currently composed of 28 members. The financial crisis of 2007/2008 and the sovereign debt crisis that began in 2010 showed that in an international financial world, risks cannot realistically be contained to single states, let alone financial institutions. The crisis was followed by rather modest reforms at the single market level. However, Eurozone states took on the ambitious project of building a banking union with the aim of significantly deepening regulatory integration.[5] Tension results from the fact that the Eurozone states—while pursuing deeper regulatory integration—are members of the single market at the same time.

3. The New Regulatory Landscape

A. Why European Financial Regulation?

Financial activity takes places across borders. There is no doubt that, even on an international level, banks cater for positive effects, such as the provision of a payment system, the diversification of risks for depositors, and the allocation of available short term capital to long term projects.[6] From an economic point of view, there is nothing in principle wrong with this as long as the economic risks inherent to the financial industry are not imposed on third parties. Banks' reliance on short term finance makes them dependent on the trust of market participants.[7] The sudden withdrawal of this short term finance may render their business insolvent. Creditors of banks B and C may take the difficulties of the first bank A as an indication that their banks will not be able to pay back loans, irrespective of the actual situation of B and C. Consequently, their creditors will also withdraw

[5] Cf. Communication from the Commission to the European Parliament and the Council, 'Roadmap towards a Banking Union', COM/2012/0510.

[6] Cf. John Armour et al, Principles of Financial Regulation (OUP, forthcoming 2016), Ch. 13.

[7] John Armour et al (n 6) Ch. 13.2.2.

their short term financing.[8] This leads to a vicious and indeed 'contagious' circle of reinforcing withdrawals of credit, ultimately endangering the viability of banks' business models and the real economy as a whole.[9]

The dangers for the economic system that come with financial activity materialise in the shape of either economic crises or state bailouts. Put differently, the financial risks taken on by individual actors may impose economic costs on society at large ('negative externalities' or 'costs'). To prevent these economic costs from arising in the first place, banks are subject to special regulation. Regulation seeks to internalise the costs into the banks' business models[10] by requiring, for example, a certain amount of equity to absorb losses.[11]

B. The European Dimension of Financial Regulation

Because of the interconnectedness of financial institutions in the single market, reference is often made to an internal market of financial services.[12] There is nothing special about the debt of a Finnish company ending up as an asset held by a Spanish bank. At the same time, the interconnectedness of the financial markets entails cross-border externalities.[13] In the same way that a financial institution may suffer from another bank's difficulties, financial systems in member states B and C may suffer from a financial crisis in member state A. This calls for regulation at the European level.[14] Two fora for regulation have to be distinguished: the single market on the one hand, encompassing all members of the European Union, and, on the other hand, the newly formed banking union.

1. The Eurozone: The Single Market

A common effort to regulate the financial industry is nothing new in the single market's legal framework. For instance, prudential regulation for banks has been harmonised through banking directives while, at the same time, leaving national legislators and regulators with wide discretion to transpose them into national law

[8] As an illustrative example for this mechanism in the onset of the financial crisis (within the shadow banking sector) see Gary Gorton, 'Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007' (Federal Reserve Bank of Atlanta's Financial Markets Conference, May 2009).

[9] Cf. John Armour et al (n 6) Ch. 13.2.2.

[10] Cf. Anthony Ogus, Regulation: legal form and economic theory (Hart Publishing, Oxford, 2004) 35.

[11] John Armour et al (n 6) Ch. 13.2.3.

[12] Recital 7, Council Regulation (EU) 1093/2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ 2 331/12 (henceforth EBA-REG).

[13] Guido Ferrarini and Luigi Chiarella, 'Common Banking Supervision in the Eurozone: Strengths and Weaknesses' (2013), ECGI Law Working Paper No 223/2013, 9 pp <http://ssrn.com/abstract=2309897> accessed 19 July 2016.

[14] Recital 1, 2 EBA-REG.

and regulatory practice. However, the Europe wide materialisation of systemic dangers in the shape of the financial crises laid bare the need to further deepen regulatory and supervisory integration at the European level. Consequently, reforms brought about significant substantive and institutional changes.

For the first time, the elementary provisions of banking regulation concerning own funds and liquidity were laid down in the harmonising and directly applicable Capital Requirements Regulation[15] ('CRR'), leaving no discretion to national legislators and regulatory agencies. This is complemented by the Capital Requirements Directive[16] ('CRD IV') concerned, *inter alia*, with: the governance of banks, a directive on deposit guarantee schemes[17] ('DGS') to provide for common rules on the insurance of bank deposits, and the bank recovery and resolution directive[18] ('BRRD'). The BRRD sets rules for the resolution of banks. These provisions form what is deemed the 'single rulebook of financial services'.

Equally significant are the changes to the institutional landscape. Member states agreed on the creation of the European Banking Authority[19] ('EBA'), charged with further harmonising the common rules and their application by provision of technical standards, guidance and the coordination of supervisory processes among national supervisors.[20] Unlike the European Central Bank, only in extreme circumstances is the EBA given direct supervisory powers vis-à-vis banks.

2. The Eurozone: A Banking Union

In the wake of the sovereign debt crisis of 2010, Eurozone leaders agreed on the creation of a banking union comprising three pillars. It comprises a single supervision mechanism ('SSM') that serves as a basis and precondition for a single resolution mechanism ('SRM'), and an envisaged common deposit insurance.[21]

This ambitious project responds to what can be described an 'implicit liability' for member states in the Eurozone: banks, at times, impose negative externalities onto the entire financial system. In order to avoid harmful economic distortions following from that, states often choose to bail out financial institutions on the

[15] Council Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 176/1.

[16] Council Directive (EU) 2013/36 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 2 176/338.

[17] Council Directive (EU) 2014/49 on deposit guarantee schemes [2014] OJ L 173/149.

[18] Council Directive (EU) 2014/59 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council [2014] OJ L 173/190.

[19] Cf. EBA-REG.

[20] Art. 8 EBA-REG.

[21] Euro Area, 'Summit Statement' (29 June 2012).

brink of collapse. Risks taken by individuals thereby end up in the hands of the public. Unlike members of a mere single market, however, member states of the Euro currency union do not have their own central bank and so only have a difficult route to financing by the European Central Bank ('ECB'). As a consequence, member states are pressured to leave the currency union. Such a step is feared to wreak havoc on the economies of other members of the Union, again inducing these states to indirectly assume responsibility for the first member states' debt. This is what happened with the European Stability Mechanism's ('ESM') financing of Greece, for example.

Common responsibilities, like access to ESM funds or the envisaged deposit insurance backstops, however, call for a common control that the EBA cannot provide.[22] Otherwise, banks have no disincentive to continue building financial risks, and national supervisors persist in overlooking these risks. This control is to be provided by the assumption of supervisory tasks by the ECB within the framework of the SSM. The ECB is given the task of directly supervising the Eurozone's 130 largest banks.[23] The ECB's remit also enables it to indirectly influence the national authorities' conduct towards the remaining banks by way of regulation, guidelines or general instructions.[24]

C. Diverging interests

Although the goals of regulation in the single market and the banking union are similar to a great extent, the level of integration is likely to diverge. This can be explained by the marked need for harmonisation within the banking union. Its success—the yardstick here being the economic survival of the currency union—depends on a stringent and coherent approach to financial regulation, which is likely to align all participants to act for the common goal. It also has the strong institutions necessary to achieve this goal.

1. 'Saving the Euro'

The sovereign debt crisis showed that there are implicit liabilities for all member states participating in a currency union. However, a common approach towards supervision alone will only help in respect of the specific externalities within the currency union. Chiefly, what may be needed is stringent regulation. It is quite clear that the ECB's rule making competences will only be confined to

22 Philip Whyte, 'Britain, Europe and the City of London: Can the triangle be managed?' (Centre for European Reform Essays, July 2012) 6.

23 Art. 6 section 4 Council Regulation (EU) 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63 (henceforth SSM-REG).

24 Art. 6 section 5 lit. a) SSM-REG.

administrative rule-making and might, therefore, not satisfy this demand.[25] This raises the issue of possible primary legislation, coming from the European level, that would be binding on all European single market participants, including the United Kingdom, to address this need. That way, the United Kingdom might be subjected to legislation tailored to Eurozone needs.

Banking union members as a whole have a strong interest in the coherent and effective regulation and supervision to remedy said negative externalities. Furthermore, such common control also serves as a moral and political precondition for access to common funds in shape of the ESM and the envisaged deposit insurance. Costs of badly drafted regulation and supervision of banks in member state A should not be borne by the uninvolved member states B, C and D. To attenuate the possibility for such 'moral hazard' behaviour of member states, a level playing field for financial services must be provided.[26] This is a project that may well translate into a legislative desire for very detailed and comprehensive harmonisation. The frequent mentioning of the 'single rulebook' being the 'backbone' of the banking union speaks volumes.[27]

2. Shielding the City

Although the situation is likely to change materially post-Brexit, the case of the United Kingdom still serves as an illuminating and representative example for the issue all non-Eurozone members of the single market face. In 2014, the contribution of the financial services sector to the United Kingdom's economy amounted to £127 billion in gross value added; around 8% of the total national output.[28] This is significant compared to Germany and France, whose financial industries only make up around 4%.[29] Beyond that, the export of financial services of the United Kingdom to the EU amounted to £20 billion, contributing about 1% of its GDP.[30] It follows that regulatory efforts impairing the financial industries' profitability for

[25] Art. 4 para 3 SSM-REG.

[26] Guido Ferrarini, 'Single Supervision and the Governance of Banking Markets' (2015), ECGI Law Working Paper No 294/2015, 3 <http://ssrn.com/abstract=2604074> accessed 18 April 2016.

[27] Cf. Council <http://www.consilium.europa.eu/en/policies/banking-union/single-rulebook> accessed 18 April 2016.

[28] Gloria Tyler, 'Financial Services: contribution to the UK economy' (House of Commons Library, 26 February 2015) <http://www.parliament.uk/briefing-papers/sn06193.pdf> accessed 18 April 2016.

[29] Statista, 'Anteil des Finanzsektors an der Bruttowertschöpfung Deutschlands von 1995 bis 2014' <http://de.statista.com/statistik/daten/studie/309545/umfrage/anteil-des-finanzsektors-am-deutschen-bip/> accessed 18 April 2016.

[30] Mark Hanrahan, 'Brexit: London Financial Sector Divided Over Risks of EU Departure' International Business Times (18 February 2016) <http://www.ibtimes.com/brexit-london-financial-sector-divided-over-risks-eu-departure-2311226> accessed 18 April 2016.

all member states will harm the United Kingdom's economy significantly more than others.[31]

This estimate is in juxtaposition to the supposed aim of financial regulation, namely benefiting the economy as a whole by the internalisation of negative externalities caused by financial activity. However, in a single market, those externalities are also imposed on parties sitting across borders, as the financial crises illustrate.[32] In that case, appropriate financial regulation will primarily benefit these countries' economies, while taking benefits from the City, previously enjoyed by the lack of internalisation.[33] The real impact of financial regulation can, ultimately, only be proved by reality. For the sake of the argument, this article henceforth assumes intrusive financial regulation may be detrimental to the United Kingdom's and other non-Eurozone member states economic interest.

In any case, this article is only concerned with what may be *perceived* as a threat in this regard. Calls for 'safeguarding' the City drew on the fear of other member states deliberately or recklessly harming the United Kingdom by introducing burdensome regulation at the European level, thereby damaging the country's economic model.[34] In general, this danger has always existed in the single market. The formation of the banking union, however, brings along a new level of common interest for strong regulation among participating members that makes this concern more severe.[35]

Having similar interests significantly facilitates coordination among actors. If the perceived costs that regulation brings are not evenly distributed among member states, unaffected countries have less incentive to abstain from harmful legislation. It was noted that Eurozone members have a common interest in strong regulation aimed at reducing moral hazard incentives and securing coherence of regulation and supervision.[36] In contrast, the United Kingdom's economic exposure to the financial sector attenuates its interest in strong financial regulation—at least as long as the United Kingdom's overall benefits from that regulation in the way that tax revenue from the financial sector minus the incurred costs from bail outs or economic crises is positive.[37] The bloc of 19 Euro countries may decide on regulatory projects among themselves (coordinated by the ECB or in Eurogroup

[31] Whyte (n 22) 4.

[32] Cf. John Armour et al (n 6) Ch. 4.6.

[33] This does not not necessarily imply that current regulation is softer than in other member states of the single market, cf. Whyte (n 22) 4, but given the integration of the banking union it might well be in future.

[34] Alex Barker (n 3).

[35] See Section 3.B.2.

[36] ibid.

[37] Cf. John Armour et al (n 6) Ch. 4.6.

meetings) and subsequently force this regulation through single market institutions. This phenomenon is what is referred to as the 'Eurozone caucus'.[38]

Not only could this facilitate the introduction of rules that harm the non-Eurozone members of the single market, it is also to be doubted whether their concerns will be seriously heard and taken into account at all, given that it will be outvoted anyway. As a consequence, the United Kingdom may lose its influence over the rules set for financial markets.[39] The United Kingdom has already lost the fight over rules on bankers' bonuses included in CRD IV and its further specification by the European Banking Authority. Remarkably, not a single non-Eurozone member state stood by the United Kingdom. A source of valuable experience and knowledge of policymakers and regulators, which could otherwise be harnessed to the benefit of the entire single market, may therefore in fact be left untapped.

4. The Potential for Discrimination in European Law-Making Procedures

The arguments above concern discrimination in the relevant procedures of financial law-making in the EU, which could, allegedly, result in detrimental and burdensome legislation for financial centers outside the Eurozone, such as the City of London and other non-Eurozone member states.[40] In an attempt to structure these concerns, it is illuminating to distinguish between two sorts of procedures. Firstly, there is the ordinary legislative procedure, which is especially used in Art. 114 Treaty on the Functioning of the European Union[41] ('TFEU')—allowing for a harmonisation of national rules aiming at the establishment and functioning of the internal market. Secondly, there are the voting rules in the agencies, especially the EBA (see Art. 44 EBA-REG), whose task it is to implement and complement the substantive banking regulation laws in daily practice. Both are potential sources of perceived discrimination from the perspective of non-Eurozone member states.

A. Voting in the Council of the European Union

The ordinary legislative procedure according to Art. 294 TFEU entails a qualified majority vote ('QMV') by the Council. The Single European Act in 1987 was the first instance where the member states—thereby amending the European Treaties—decided to depart from the unanimity requirement for voting in the

[38] Frank Vibert, 'Can Cameron achieve a new relationship between member states inside the Eurozone and those outside?' (BrexitVote, 20 November 2015), accessed 18 April 2016.

[39] Whyte (n 22), 6.

[40] See Section 3.C.2.

[41] This competence to harmonise has been widely used to establish the new supervisory authorities and substantive regulatory harmonisation in the past few years, see, for example, EBA-REG or CRR.

Council with regard to the Single Market and established a QMV procedure.[42] Yet, even under the Lisbon regime, there is an amended and rather complicated mechanism which tries to secure the interests of all member states while still allowing for efficient decision making, Art. 16(4)(5) Treaty on the European Union ('TEU').

The potential for discrimination arises from the fact that in the competent Ecofin Council,[43] the Eurozone member states have the necessary majority by themselves.[44] This makes it difficult for those countries which are not members of the Eurozone to influence the general framework of regulatory policy and the legal texts to a satisfying extent. Under the new mechanism established by the Treaty of Lisbon, which finally replaced the old mechanism on 1st November 2014, the 19 Eurozone members exceed the 65% qualified majority threshold and hence do not need the non-members to agree to their proposal. The assumption that this is, or could be, exploited remains speculative because it seems almost impossible that a proposal opposed by most of the non-Eurozone members would have a chance of success in the European Parliament. Furthermore, it is far from given that the Eurozone members would, as a whole, pursue a single regulatory strategy.[45]

However, the fact remains that the harmonised banking regulation rules, as incorporated in the CRR, are predominantly shaped and influenced by the Eurozone members and cannot be opposed by the non-Eurozone members, let alone by a single state like the United Kingdom. This of course reflects the current status of the EU in terms of integration because any member state can be outvoted in the Council. Whether there are effective safeguards against considerable harm to national policy by being outvoted shall be discussed in Part C of this Section.

B. Agency Rule Setting: The Arrangement in the EBA

Apart from the ordinary legislative procedure, there is a second formal source of discrimination identified by British fears. The main agency responsible for the implementation of the substantive regulatory laws, for soft law guidance, and the systemic stability of the financial system as a whole is the EBA, located in London. The EBA was equipped with a double majority voting rule, intended

[42] For an overview of the important changes brought about by the Single European Act see Maria G. Cowles, 'The Single European Act' in Erik Jones, Anand Menon and Stephen Weatherill (eds), The Oxford Handbook of the European Union (OUP 2012).

[43] Ecofin is the common abbreviation for the Economic and Financial Affairs Council. The Ecofin Council is the Council of the European Union in the special area of economy and finance. It is made up of the economics and finance ministers from all member states.

[44] See the detailed chart of the voting shares in British Bankers Association, Eurozone Caucasing, A Challenge to the European single financial market (June 2014) 14.

[45] Paul Craig and Menelaos Markakis, "The Euro Area, its Regulation and Impact on Non-Euro Member States, in Panos Koutrakos and Jukka Snell (eds), *Research Handbook on the Law of EU's Internal Market* (Edward Elgar, 2016) (forthcoming) 4(a)(i); also Vilbert (n 38).

to secure the interests of the member states without the Euro as their single currency.[46] When adopting a new standard or rule, the mechanism requires that there is sufficient support by Eurozone members and non-Eurozone members. It seems that British fears are less salient here because the non-Eurozone members succeeded in introducing this safeguard. Yet again, a single country cannot oppose certain initiatives of the authority if it does not find sufficient allies amongst its group. A pertinent example for this was the introduction of bankers' bonus caps promoted by the EBA, where the United Kingdom could not gather enough support for its opposition. Although the United Kingdom lodged an application of annulment at the European Court of Justice ('ECJ') as a result, it decided to withdraw the application once Advocate-General Jääskinen issued his opinion and recommended dismissal of the application.[47]

C. Discrimination as a Legal Test in a Voting Procedure

The specific form of discrimination that could arise in these circumstances is twofold. Firstly, the fear is that the ordinary legislative procedure allows the integrated Eurozone members to implement their view of regulatory policy by setting up rules which serve their interests. Secondly, the non-Eurozone members seem to assume that the EBA is a possible danger to financial centres outside the Eurozone as long as it orientates its regulatory policy along the interests of the Eurozone.

Legally speaking, both submissions raise the same formal question: is it possible that the outcome of the Union legislative process could technically amount to a discrimination of one specific (group of) member state(s) because the interests of the Eurozone members can be different from those of the non-Eurozone members? The question at the moment is not whether Art. 18 TFEU, which prohibits any discrimination on grounds of nationality, or any general principle of non discrimination under Art. 6(3) TEU,[48] covers this form of discrimination, but whether it is *ex ante* possible, once the respective procedure for the adoption of the legal text is followed.

[46] See Art. 44 EBA-REG. Note that it is almost impossible for the EBA to remain in London after the envisaged Brexit, which was already confirmed by EU officials in the aftermath of the UK Referendum.

[47] Case C-507/13 UK/Parliament and Council (ECJ, order of 09 December 2014); it is a rare case where the exception of Art. 51 Statute of the Court of Justice of the European Union applies so that the ECJ had direct jurisdiction in an action of annulment and not the General Court.

[48] This provision enables the ECJ, *inter alia,* to derive general principles of EU Law from constitutional traditions common to the member states. See, especially with regard to non-discrimination based on age, Case C-144/04, Mangold, [2005] ECR I-9981.

1. Discrimination by Being Outvoted

It is indeed hard to imagine that this question concerning discrimination can be answered in the affirmative because the European Treaties (TEU and TFEU) as an agreement of all member states ensure that the procedural and substantive interests of each of them are safeguarded to an appropriate extent in the respective fields of action. At the same time, there are material safeguards such as the principle of conferral or the principles of subsidiarity and proportionality, which are stipulated in Art. 5 TEU, that prohibit legal infringements, so that voting rules departing from unanimity as such cannot be exploited to harm disagreeing member states. In the area of interest at hand, one could point to the single market of financial services which is not to be impaired by measures that benefit the Eurozone, such as a deeper integration in banking supervision. Being outvoted in a majority decision cannot therefore amount to discrimination as such. A suitable mechanism depends on the member states as a whole. They set up a system where they find individual interests are sufficiently taken into account while ensuring a smooth decision making process.

5. A Perspective from the Principles of Proportionality and Subsidiarity

It is possible to reinterpret the concerns by focusing on the outcome of legislative procedures for the member states. The claim is that the EU imposes a regulatory concept that is dominated by Eurozone concerns and does not properly take into account the interests of a non-Eurozone financial centre like currently the City of London. Put this way, the claim is one of the vertical competence principles of subsidiarity (a certain measure has to be taken at the most appropriate level, for example the member state level) and proportionality (a European legislative or administrative act may not go beyond what is necessary to achieve the envisaged aim) as stipulated in Art. 5(4) TEU[49], preventing the EU from encroaching on member states competences in an unjustified way.[50] These principles intend to ensure that once the EU has a competence to act, this competence has to be exercised in a way that secures the competences which remain with the member states. An example is adopting a Directive rather than a Regulation because the

[49] The wording of Art. 5(3) and Art. 5(4) TEU is: 3. Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.
4. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

[50] As most of the secondary law instruments are agreed upon using Art. 114 TFEU as internal market competence, both concepts apply to this shared competence, Art. 4 (2) (a) TFEU.

former generally, especially in its minimum harmonising form, gives the member states some leeway in implementing it. Applications challenging EU legislative acts based on such concerns became significantly more important with the introduction of a QMV system in the Council because those member states who did not support a proposal could challenge the proposal before the ECJ.[51]

Turned into a subsidiarity and proportionality claim, *viz.* that the planned regulative act is too intrusive and encroaches on the member states' area of competence, the interesting structural point remains that the argument does not rely on the regulatory autonomy of all member states potentially harmed by the harmonising legal act. Rather, it entails that individual member states are worse off because the impact on their financial sector is more severe than on other affected member states. However, the principles of subsidiarity and proportionality are designed to operate in order to maintain the vertical competence division as established by the TEU and TFEU and to prevent competence creep by the EU legislature, and not to balance the interests of individual member states in the political bargain.[52] It can be argued that the instruments of proportionality and subsidiarity review are not intended to legitimise political fears of those member states who did not convince the majority in the law making process. Instead, they are concerned with an objective, abstract assessment of the regulatory project in question with regard to an existing EU competence. As R. Liddle put it recently: 'A veto right for London on City questions would also breach a fundamental principle of the EU. If every member state demanded special protection for the sector which was most crucial to its economy, there would be no single market'.[53] This means that an interpretation of the principles governing European legislation as allowing individual member states to protect and veto whatever, in their view, is economically important would undermine the very concept of the integration, be it in the Eurozone or in the entire EU.

6. Safeguards against Potential Threats to National Interests

It is clear that the terminology of discrimination in relation to voting procedures is inappropriate. Nevertheless, it is illuminating to carve out the means by which individual or group interests of member states in the European legislature are protected and to assess whether these mechanism discussed below function as

[51] The most important case in this regard so far is Case C-376/98 Germany/Parliament (Tobacco Advertising I) [2000] ECR I-8419, because it is the only occasion the ECJ found Art. 114 not to be the correct legal basis and invalidated the legal act. In this case, Germany was outvoted in the Council and subsequently brought an action for annulment.

[52] See, Paul Craig, 'Subsidiarity: A Political and Legal Analysis' [2012] JCMS 72.

[53] Roger Liddle, 'Securing fair treatment between the "euro-ins" and "euro-outs"' (Policy Network, 6 November 2015) <http://www.policy-network.net/pno_detail.aspx?ID=4999&title=Securing+fair+treatment+between+the+%E2%80%98euro-ins%E2%80%99+and+%E2%80%98euro-outs%E2%80%99> accessed 15 January 2016.

effective means for safeguarding national interests, such as those of the United Kingdom in the financial regulation debate. In this respect, it is essential to distinguish between formal safeguards such as the discussed voting rules and substantive safeguards that constrain the action of the institutions.

A. Formal Safeguards: Voting Rules

Formal safeguards deal with procedural requirements in reaching decisions, as opposed to substantive mechanisms where the main tool at work is court scrutiny, and can be qualified as *ex ante* measures since they are used to ensure that the relevant interests are taken into advance. The most important formal safeguards when it comes to taking into account diverging interests at the European Union level are voting rules. Naturally, unanimity would be the strongest safeguard against any perceived discrimination because all interests would be accommodated. It is not surprising that the British government in 2011 proposed such a unanimity rule for voting that affected financial regulation rules.[54] The proposal failed as it did not attract enough support by other member states. The United Kingdom finally refrained from subscribing to the European Fiscal Compact.[55] The most important step with regard to voting rules certainly came about with the Single European Act 1987 which finally abandoned the unanimity requirement for agreeing on legislative proposals in the Council of the European Union for matters regarding the Single Market.[56] This marked a milestone in the integration process as it formed the transition from purely intergovernmental to a more supranational model where legislative acts could become binding on member states that did not support them, thus a major restriction on the sovereignty of each member state.

A weaker version of a voting rule safeguard has been implemented in the decision making process of the EBA, where according to the double majority requirement of Art. 44 EBA-REG Eurozone members as well as non-Eurozone members need to support the proposal to a significant extent, a simple majority of each group. Of course, voting rules in this procedure are not an efficient safeguard because the same lock does not exist in the law-making Council, so that the binding regulatory rules as such cannot be vetoed by the non-Eurozone members. Only the standards and technical rules which fall in the rather tightly constrained competence of the EBA can be vetoed this way.[57]

[54] ibid.

[55] For a detailed assessment see Michael Gordon, 'The United Kingdom and the Fiscal Compact: Past and Future' (2014) 10 European Constitutional Law Review 28.

[56] See Section 4.A.

[57] This is partly due to the Meroni doctrine of the ECJ; see Case 9/56 Meroni/High Authority [1958] ECR I-0011. For a thorough discussion of the current application of the doctrine, see: Merjin Chamon, 'EU agencies: does the Meroni doctrine make sense?' [2012] Maastricht Journal of European and Comparative Law 281.

There is a softer proposal to resolve issues of diverging interests in the decision-making process that would allow one member state to raise its concerns, the so-called 'Ioannina clause',[58] which essentially provides that each time a member state feels disregarded by its counterparts and raises concerns of national interest, it can elevate the respective topic from the Council to the head of states and governments in the European Council which then needs to find a solution. This idea was taken up in the European Council negotiations for the 'New Deal for the United Kingdom'. The decision—intended to take effect if the United Kingdom had voted to remain in the EU—contains a clause that enables a request for a discussion of the European Council on proposals which concern non-Eurozone members.[59]

In short, there are several formal safeguards in place to assuage the fears of non-Eurozone member states in relation to discrimination. Moreover, there would be at least four ways of implementing them in the EU legal order, each of them bearing different constitutional weight.[60] It is clear that the formal safeguards currently in place are not sufficient to reconcile the concerns raised by the United Kingdom in the debate of financial regulation but rather follow the integrationist path under way since the Single European Act. Thus, without significant changes, the procedures in the respective institutions in this sense do not provide an effective way of dealing with the fears of non-Eurozone members.

B. Substantive Safeguards in the European Treaties

The interests of a minority, such as the non-Eurozone members, do not have to be taken into account where there is a sufficient majority without those member states. The question that then arises is: what are the substantive legal safeguards for those minority interests, which protect them from being harmed in a legally relevant way and not just politically outvoted? The most obvious tool to scrutinise these legal acts is to challenge their legality by filing an action of annulment at the General Court under Art. 263(1), 256 TFEU, where member states, according to Art. 263(2) TFEU, are so-called 'privileged applicants'; they do not have to establish

[58] See Vibert (n 38). The origin of the term Ioannina-clause or compromise dates back to a Council meeting in this Greek city, see <http://eur-lex.europa.eu/summary/glossary/ioannina_compromise.html> accessed 18 April 2016.

[59] Conclusions of the European Council, EUCO 1/16, 19 February 2016. This new deal is discussed in great detail at by Paul Craig and Menelaos Markakis, (n 45). For the discussion of the Ioannina-clause (labelled 'emergency break') see ibid at 4(b)(v).

[60] Cf. Vibert (n 38), mentioning agreements (i) between members of the European Council, or (ii) between the institutions (Council, Commission and EP), or (iii) by a Protocol attached to the Treaties, or (iv) by changes to the internal provisions of the Treaties.

a specific legal interest in bringing proceedings.[61] The grounds for annulment are, however, limited to those mentioned in Art. 263(4) TFEU, so that general challenges seeking an overall assessment of a legal act are excluded. Furthermore, in judicial proceedings, the underlying policy concerns are not balanced again; rather, policy concerns are replaced by the court's assessment since this will not threaten the institutional balance. The long-standing jurisprudence of the European Court is to grant the EU legislator, as well as an expert decision-making body such as the EBA, a broad margin of discretion to reach specific policy decisions through the defined procedures.[62] Nonetheless, the Treaties place limits on this discretion which—regarding minority interests—primarily consist of the following principles, which act as constraints on the EU legislator.

1. Art. 18(1) TFEU: Non-Discrimination

Art. 18(1) TFEU provides that within 'the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited'. Art. 18 TFEU makes clear that the principle of non-discrimination forms one of the central pillars of the European Union's self-understanding. However, it is doubtful whether Art. 18 TFEU can be operationalised in the present context because the wording 'on grounds of nationality' as well as the systematic context of the provision, i.e. Part Two of the TFEU on Non Discrimination and Citizenship, indicate that the object of protection are the union citizens as individuals,[63] or the individual economic entities relevant for the free movement provisions. Art. 18 TFEU therefore seems to be a rather weak tool to challenge a legislative act with the argument that a member state was discriminated because his interests were not sufficiently taken into account. This terminology is questionable because of the very fact that the procedures in the TFEU preclude a direct discrimination from taking place. For example, the United Kingdom recently challenged a measure by the ECB claiming precisely that 'the ECB's location requirement infringes the principle of non

[61] In Case T-496/11 UK/ECB (CFI, 4 March 2015), where the UK successfully challenged the ECB's regulatory power to require clearing houses to be established in the Eurozone, this was discussed thoroughly as the UK is not part of the Eurozone. Despite contrasting reports, this decision contains no legal strengthening of the single market as opposed to an alleged policy of the ECB to discriminate the non-Eurozone member states, because the application was successful even before these matters were dealt with.

[62] See, for example, Case C-58/08 Vodafone and others [2010] ECR I-4999, para 52, pointing to the usually applied test that a measure has to be 'manifestly inappropriate'.

[63] Armin von Bogdandy, 'Art. 18 TFEU' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (eds), *Das Recht der Europäischen Union* (57th supplement 2015) paras 29 ff; Astrid Epiney, 'Art. 18 TFEU' in Christian Calliess and Matthias Ruffert (eds), *EUV/AEUV* (4th edition 2011) para 45.

discrimination in Article 18 TFEU'.[64] It is not clear from the judgment whether the argument is intended to point to discrimination of the member state or of the individual actors in the financial market in London since the Court did not have to assess this claim as it succeeded already based on other grounds. It is submitted here that only the latter claim is substantiated under Art. 18 TFEU because Art. 18 TFEU is explicitly addressed to the individual citizen of the European Union. Non-discrimination on the basis of Art. 18 TFEU can hardly be used with regard to an alleged discrimination of a single member state's interest in a specific policy *per se*.

In the context of financial regulation, one could imagine a potential discrimination of currencies other than the Euro, which is prohibited by the *lex specialis* to Art. 18 TFEU, the free movement of capital in Art. 64 TFEU, so that indirectly the Member State of this currency is harmed. This point is substantiated by Pavlos Eleftheriadis in the context of discussing the ECJ's judgment with regard to the ECB's location requirement mentioned in the last paragraph, which after the Brexit-vote presumably is legal history.[65] Such a perspective—although less relevant for the discussion of a possible discrimination of a member state *per se*—is illuminating and leads to the conclusion that the internal market is protected and hierarchically superior to Eurozone interests. Thus, potential discrimination of non-Eurozone members of the EU, which materialises itself in a less favourable treatment of the currency other than the Euro, falls under the pivotal free movement provisions. Therefore, legal protection against an act of the EU, or even of another member state, is available via the available mechanisms in the TFEU. Yet, in the context of common rule setting at the European level for example via the EBA, it is hard to imagine that a single currency outside the eurozone is discriminated in a legally relevant way.

2. Article 4(2), TEU: Equality of Member States

The 'Equality of Member States before the Treaties' is a primary legal principle, see Art. 4(2), TEU. It is intended to complement the protection of the national identities of the member states, stipulated in the same paragraph.[66] The ECJ stated in the context of new and old member states: 'The European Union is a union based on the rule of law, its institutions being subject to review of the conformity of their acts, *inter alia*, with the Treaty and the general principles of law. [...] Those

[64] UK/ECB (n 61) para 78.

[65] Pavlos Eleftheriadis, 'The Proposed New Legal Settlement of the UK with the EU' (*U.K. Const. L. Blog*, 13th February 2016) <https://ukconstitutionallaw.org/> accessed 15 July 2016.

[66] On the interaction of national identity and equality in the context of the supremacy debate, see Federico Fabbrini, 'After the OMT Case: The Supremacy of EU Law as the Guarantee of the Equality of the Member States' [2015] German Law Journal 1003. It should be briefly noted that the threshold for 'national identity' is significantly higher than arguing about a regulatory policy in the City of London so that this provision is not discussed by itself.

principles are the very foundation of that union and compliance with them means, as is now provided for expressly in Article 4(2) EU, that the new member states are to be treated on the basis of equality with the old member states.'[67]

It is crucial to understand that equality in principle can be infringed in two ways: firstly, if like cases are not treated alike without objective justification, and; secondly, if unlike cases are treated alike without objective justification. It is only the latter possibility that is at stake in the debate about financial regulation rules that apply for the entire single market but can be agreed upon without the consent of the non-Eurozone countries. Although it is submitted that the equality mentioned in Art. 4(2) TEU is apt to safeguard smaller or less powerful states from EU law being exploited,[68] it does not act as a safeguard to being outvoted in a political agreement upon regulatory policies as long as EU law is not infringed. This underlines that *a priori*, the primary purpose of Art. 4(2) TEU in the context of equality is the first limb of the principle of equality mentioned above, i.e. that the EU shall be prohibited from treating member states differently where it is not foreseen by the Treaty.

Technically the equality requirement is closely linked with non-discrimination. One could describe these legal instruments as two sides of the same coin, non-discrimination being a negative prohibition and equality being a positive requirement. The useful peculiarity in our context of competing member states interests is that it is specifically the equality of these member states that is protected by Art. 4(2) TEU. As to the content, it is clear from the outset that equality before the Treaties already entails that the concept of equality does not require that all member states are always treated alike. Rather, a different treatment if set up in the Treaty is incontestable, for example the regulation for the allocation of MEPs for each member state in the European Parliament in Art. 14(2) TEU.[69] Another example can be found in the context of the single market for financial services. Art. 139 TFEU shows that the Treaty acknowledges the different status of Eurozone members and non-Eurozone members.[70] This contextualisation already indicates that it will be very hard to argue with the concept of equality of member states when trying to tackle legislative proposals that perhaps fit one of those categories more than the other, as long as the procedures which the Treaty requires are observed. Rather, as has been pointed out by Federico Fabbrini, equality argues for a uniform application of EU law because the equality is threatened by the very fact of allowing a single member state to derogate from it or raise national concerns in

[67] Case C-336/09 Poland/Commission (ECJ, 26 June 2012), paras 36 ff.

[68] See Armin von Bogdandy and Stephan Schill, 'Art. 4 TFEU' in Eberhard Grabitz, Meinhard Hilf and Martin Nettesheim (n 63) para 8.

[69] Example taken from von Bogdandy and Schill (n 68) para 7.

[70] See Walter Obwexer, 'Art. 4 TFEU' in Hans von der Groeben, Jürgen Schwarze and Armin Hatje (eds), *Europäisches Unionsrecht* (7th edition 2015) para 24.

varying contexts and thus allowing an EU à la carte.[71] Therefore, 'equality before the Treaties' cannot be invoked to demonstrate a breach of Union law just by being outvoted in the respective bodies.[72]

3. Article 114, TFEU and the Single Market

Article 114 TFEU was used as a legal basis for most of the new rules and agencies in the framework of European financial regulation.[73] One therefore initially has to assume that the substantial arguments of non-Eurozone countries such as the United Kingdom fall on fertile ground in Art. 114 TFEU. These countries substantially claim that the single market of financial services (freedom of movement for capital and services) may not be hampered by the deeper integration of the Eurozone in the context of the banking union and their majority in the Council as well as in the EBA.[74] A regulatory measure adopted under Art. 114 TFEU according to the ECJ 'must genuinely have as its object the improvement of the conditions for the establishment and functioning of the internal market'[75]. This conveys the impression that it operates as the best safeguard against discrimination of non-Eurozone member interests. There are several discrepancies in the approaches towards regulatory policies that should be pursued especially between the Eurozone and the non-Eurozone countries such as the United Kingdom.[76] The intention of Art. 114 TFEU clearly is to foster the internal market, and not a subset of it, such as the Eurozone.

Yet, for several reasons, it is difficult to construe Art. 114 TFEU as a safeguard against a specific regulatory policy that fits some member states better than others. First, the ECJ only once quashed a legislative proposal based on Art. 114 TFEU for lack of competence and in principle accepts the arguments of the EU legislature for which the ECJ developed a rather loose guide so that the threshold to fulfil the harmonisation criterion is lower than a first glance suggests.[77] Second, the focus is clearly on the single market and Eurozone concerns do not appear in a harmonisation measure based on Art. 114 TFEU. Nevertheless, the scrutiny of the Court—whether the correct legal basis was chosen and whether its requirements

[71] Federico Fabbrini (n 66) 1003, 1005; see, also, Case C-174/08 NCC Construction Danmark [2009] ECR I-10567, para 24.

[72] The same argument applies for Art. 4 (3) TEU. Under the assumption that the principle of sincere cooperation applies at all for the relationships of the (groups of) member states in a single EU institution like the Council or the EBA—which is more than doubtful—it is legally unimaginable to construct it as obliging the member states to take into account every national interest in the debate.

[73] See Section 3.B.1.

[74] See David Cameron (n 4).

[75] Germany/Parliament (Tobacco Advertising I) (n 51).

[76] The Bruges Group, The City of London Under Threat: The EU and its attack on Britain's most successful industry (The Bruges Group Publications, author: Tim Congdon) 15.

[77] Stephen Weatherill, 'The limits of legislative harmonisation ten years after Tobacco Advertising: how the Court's case law has become a "drafting guide"' [2011] German Law Journal 827.

are fulfilled—most likely does not reach out to an in depth scrutiny of the chosen underlying policy rationale. Regarding Art. 114 TFEU, it is essentially sufficient that there exist 'obstacles to the free movement'[78] which are then re-regulated on the European level and thereby replaced by European rules, such as in the Capital Requirements Regulation. However, because of the wide margin of discretion for the EU legislature,[79] it can hardly be expected that the Court finds a certain regulatory policy that was agreed upon under Art. 114 TFEU to be focusing too much on the needs of the Eurozone. Finally, it can be doubted that the single market can be accomplished if the concerns of one member state with a particular form of financial market such as the United Kingdom with the City of London are given greater weight in the shaping of legislative proposals than concerns of others. Thus, although the use of Art. 114 TFEU obliges the European legislature to set up harmonised rules apt for the entire single market, in practice this does not work as a safeguard against a specific policy pursued by the harmonisation measure.

7. Conclusion

This article has attempted to provide an economic and legal analysis of the implications of the financial regulation policy and the related legislative developments in the European Union, in particular with regards to the diverging interests between Eurozone 'caucus' and non-Eurozone member states. To illustrate this tension, we referred to the case of the United Kingdom. While the United Kingdom has an interest in promoting its internationally active financial sector, the Eurozone as a whole is, first and foremost, likely to foster strong financial regulation. This article also showed that concerns about possibly one-sided regulatory policy cannot amount to discrimination because of existing formal and substantive safeguards under European law. Non-Eurozone members' wishes to 'shield their financial industry' against the perceived threat of harmful European financial regulation are therefore hard to maintain under the current framework and can only be comprehensively realised by leaving the European Union altogether.

[78] See, for example, Germany/Parliament (Tobacco Advertising I) (n 51), paras 82–84 where the Court elaborated on the scope of the regulatory competence under Art. 114 TFEU.
[79] See Vodafone (n 62) para 52.