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Irish Periscope, International Waters

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The Ocean Currents of EU Financial Regulatory Reform:
Irish Periscope, International Waters

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Abstract

The EU integrated single market vision, which has dominated the EU financial regulatory process, may be traced to the mid-60s. Of more recent time its rationale has centred upon economic growth, where the financial services industry is a prominent market vehicle. However, the global financial crisis and its ongoing aftermath, where Ireland suffered greatly, necessitated regulatory reform calls and actions. Under the G20 global umbrella the EU Commission espoused reforms to both EU structures and mechanisms in addition to declaring enforcement an essential reform pillar. Post-reform this paper charts a shift in the institutionalised paradigm core with consequent power and organisational structure corrections, continuing complexity and power limitations, and some new hybrids outside normal institutional ambit. Marked political divergence around EU crisis response policy-making emerged, some sovereigns including Ireland became regulated entities, and EU enforcement reform is caught in time-lag, convergence quicksand, and dangers of static rules-based response.

1. Introduction:

Take a side-bar moment: Oceans are a vast, swelling, powerful motion sometimes stormy or otherwise quiescent; the currents within them differ from cold to warm and in their effects; where cold meets warm for instance, fog occurs; sailing below, a lens or periscope is needed for a view which of course is restricted; and, the waters being sailed, which may or may not teem with aqua-life, or suffer pollution, are sometimes local but more often international. This is a fitting metaphor for the financial regulation of the international financial system where an exceptional period of financial instability commenced in 2007. The stability of the entire

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financial system was questioned. Particularly heavily felt in Ireland, a model if not pivotal reform periscope, it dramatically collided with the EU where new institutions and mechanisms were established, and has reverberated internationally.

Financial markets are not a homogenous or single domain while financial regulation of these markets is thus also not a single control domain. The main areas are banking – credit institutions, insurance, securities and asset management. These cover for instance the insurance, securities (stocks and futures), currency and capital markets. These markets are highly inter-active and often integrated, and are complex, dynamic and highly innovative. Regulation, so vital to financial stability, effectively is the control of such diverse markets, and the multiplicity of both market actors and relevant products. In the Australian context for instance ASIC (Australian Securities and Investments Commission) as regulator licenses at least fifteen different domestic financial sector markets (Corporations Act 2001, Ch 7).

Taking the Global Financial Crisis (GFC) as an intellectual starting point, because of its immense potential for irreparable economic and regulatory damage, this paper focuses upon the exceptionally important reform agenda. As back-drop it commences with an overview of three over-lapping subjects: EU financial regulation pre-GFC, the financial market-place, and the wider globalisation – especially capital market - environment. It then briefly examines the international regulatory landscape, before examining three major heads of post-crisis EU financial regulatory reform: new institutions and structures, the separate new mechanisms, and better enforcement. Examples or comparators are tendered from the US, UK, the EU, Australia and Ireland.

This author argues that there has been a shift in the institutionalised paradigm core with consequent power and organisational structure corrections, continuing complexity and power limitations, with some new hybrids outside normal institutional ambit. Marked political divergence around EU crisis response policy-making has emerged, some sovereigns have become regulated entities, and EU enforcement reform is caught in time-lag, convergence quicksand, and dangers of static rules-based response.

2. EU Financial Regulation: Integrated Market: Example Securities and Investment-Services

The EU regulatory process since the 1966 Segre Report, which highlighted the poor status of EU capital and securities markets, has been preoccupied with the construction of a single financial market purposed at economic growth (Moloney 2008: 6-7). This market-based system, comprising wider and deeper capital markets replaced a system of bank-based finance. Such a common market was one of the foundation tenets of the Treaty of Rome (article 2), really an aspiration requiring concrete application, and part of a wider project to create a single market without frontiers incorporating freedom of establishment and free movement of goods, services, persons and capital (Moloney 2008: 6-7, 12; Donnelly 2010: 209).

The greatest barrier to such a single internal and regulated market was “obstructive and diverging” national regulatory regimes, which distorted competition, while the intensity of such regulation was typically dictated by several factors including market structures, investor profiles, market-place maturity, saving patterns, and cultural attitudes (Moloney 2008: 7). Thus following the EU Treaty known as the Single European Act 1986, there was enacted what has been described as a ‘juggernaut’ of EU financial market legislation geared towards market norm convergence (Moloney 2008: 4-5; Craig & de Burca 2011: 11). Additionally, the Lisbon Strategy launched in 2000 to cover the next following decade and re-launched in 2005, had both an economic and a social goal, while on the economic side it involved a shift towards a ‘dynamic, knowledge-based economy’ and information society presaged *inter alia* upon a business-friendly environment, further internal market liberalisation, and integrated financial markets (Craig & de Burca 2011: 163-164).

The EU securities regulatory system (securities and investment-services) for instance, by 2002 had matured to a point where it could be recognised as a discrete system of market regulation. By the year 2008 regulatory, supervisory and institutional change had been dramatic with the completion in 2005 of the 1999 Financial Services Action Plan (FSAP), forged within a four-part financial market rule-making process – the Lamfalussy Process – which was according to Moloney (2008: ix) a market-integration ‘crucible’. This crucible was anchored by two events. Firstly, major EU legislative reforms transposable into national law heavily accented towards greater information transparency;[2] and secondly, the arrival of the Committee of European Securities Regulators (CESR) described as a burgeoning and dynamic network-underpinned sectoral actor (Moloney 2008: ix).

Pre-crisis financial market regulation found the EU Commission constituted by itself as statutory regulator. This entailed moving from member states enjoying independent regulators, and where for companies member states had insisted upon preserving national prerogatives

[2] Including the 2003 Prospectus Directive, the 2003 Market Abuse directive, the 2004 Transparency Directive, and the cornerstone 2004 Markets in Financial Instruments Directive (MiFID).

(Donnelly 2010:241). The Commission increased its sophistication in regulatory design, and employed a larger tool-box including codes of conduct and market discipline techniques (Moloney 2008: 5). Moloney (2008: 37) described such EU securities regulation as, “the zenith of the Community method....the triumph of the command-and-control model for intervention”, (Moloney 2008: 48).

3. Financial Market: Pre-Crisis to Crisis: Crisis Causation and Reform

Financial markets changed dramatically in the fifty or so years to the new millennium. Gradually throughout the 1990s controls on capital inflows and outflows were lifted almost world-wide although the Asian financial crisis (1997), blamed on poor fundamentals and local institutions, caused some soul searching; thereafter, liberalisation continued with the US and the EU prominent advocates, and capital freedom was not questioned except perhaps in crisis situations (Chwieroth 2010: chs 8 and 9: 226). Pre-GFC massive capital inflows at low interest rates – a bonanza – associated with the recycling of savings and trade surpluses from China, other emerging market countries, and oil-producing countries fuelled asset price bubbles especially in the housing market (Chwieroth 2010: 256). The financial market response was securitisation innovation (Chwieroth 2010: 256).

For the EU with free capital movement one of the four Treaty fundamental freedoms aspirations, the fall of the Berlin Wall encouraged monetary union which grew into the Euro-zone, while Germany particularly espoused not alone EU but also world-wide unfettered capital flows (Doyle 2012). By 2007 capital controls were categorised by international financial institutions as a ‘last resort’, as being unable to reduce a country’s vulnerability to crisis, and not a substitute for sound macroeconomic policies (Chwieroth 2010: 29). A complex global network of financial flows was created, the size of annual cross-border capital flows hugely rising from approximately .5% of world GDP in the mid-1990s to approximately 20% in 2007 (Reid 2011).

Goodhart (2009: 1) has characterised the period 1992-2006 internationally as “steady growth, low inflation and interest rates, and rising employment, a ‘golden age’, perhaps the very best economic period ever”.

Contemporaneous with the hugely significant rise in capital flows was a combination of at least eight structural and cyclical factors: financial innovation; increased cross-border ownership of financial institutions; increased cross-border investment flows geared both to greater returns and changing demographic trends; reduced capital controls; increased internationalisation of manufacturing processes and labour movement; the emergence of former state-run economies; and, a low-interest environment (Reid 2011).

The prime objective in financial markets was and still is risk analysis and risk reduction (Foy 1998: xvii). Transparency, the availability and quality of market information, as we have seen from the EU legislative ‘juggernaut’, became the major focus in this endeavour (Chwieroth 2010:231). However, risk identification and pricing within financial markets depends upon constantly changing conditions (Mallaby 2010: 246).

Within this milieu, EU Financial market integration benefits were advocated to include,

- For investors, “higher risk-adjusted returns ..... through enhanced opportunities for portfolio diversification and more liquid and competitive capital markets”,
- For the corporate sector, “easier access to financing capital”,
- And, for the intermediation sector, “....competition.... [offering] companies a wider range of financial products at attractive prices”.

(Moloney 2008: 10-11, citing the EU Commission sponsored London Economics Report 2002).

The growth of many types of derivatives (including CDOs) in this liberalised innovative market was combined with a revised banking strategy which originated in the US and spread to Europe and elsewhere, entitled ‘Originate and Distribute’ under which loan business was originated (e.g. residential mortgages, credit card debt, student loans) and then pooled baskets of these loans were securitised and distributed to non-bank financial institutions (Goodhart 2009: 13). Risk problems abounded since these long-term assets were funded by short-term commercial paper. Furthermore, both the banks and the ratings agencies failed to adequately evaluate these securities (Lowenstein 2008: 318-323). White collar crime in the form of mortgage origination fraud also played a role (Nguyen and Pontell 2010: 591, 608).

Additionally, while Central Banks and international institutions prior to mid-2007 began pointing to a serious under-pricing of risk, as financial institutions in the low interest market sought to increase yield by moving into these increasingly risky assets (Goodhart 2009: 9), funds such as the IMF, the G20 Financial Stability Facility (FSF later FSB) and the Bank for International Settlements (BIS) failed to send a sufficiently strong wake-up call to policymakers or to provide operational policy guidance (Chwieroth 2010: 258). The risk model became increasingly dependent upon loan originators’ underwriting standards which proved wanting, the risk and liquidity management practices of financial institutions which proved sub-standard, and the performance of the ratings agencies which were riven with conflicts of interest (Chwieroth 2010: 257).

Thus, a period of exceptional financial instability commenced in 2007, which may be divided into two overlapping phases. Firstly, a global credit (liquidity) crunch commencing in August 2007 and secondly, a transformation into a global financial crisis (both solvency and liquidity) in September 2008 after the fall of the giant New York investment bank Lehman Brothers a major player in the mortgage-based security business; in turn panic asset selling and massive deleveraging by global financial institutions exacerbated Lehman effects (Avgouleas 2009: 24). There was a marked deterioration in market confidence and sentiment, and the stability of the entire financial system was questioned (Chwieroth 2010: 260).

Special resolution vehicles were created mid-crisis in many countries including the US TARP program which after a significant hiccup provided emergency funding for financial institutions; the UK introduced a statutory special resolution regime in the wake of bank failure (e.g. Northern Bank run) to be triggered by the FSA as regulator but with Bank of England involvement (Davies & Green 2009; Banking Act 2009); in Ireland the creation of NAMA to take over a huge national and international property portfolio; and, in the EU the creation of the EFSF/ESM bailout fund curiously as a limited liability company.

On the global stage the G20 Washington Summit in November 2008 recommended high-level measures including reform of global financial regulatory architecture and revamping national and international financial regulatory systems, although there is some criticism that some proposals relied too much upon the persuasive power of market discipline (Avgouleas 2009: 27). In the EU the de Larosiere Report commissioned in October 2008 reported in February 2009 and recommended institutional and structural reform.

The EU financial crisis response with or without international drivers presaged increased centralised command and control governance with a regulatory convergence around ‘risk’ (Frison-Roche 2010 and 2010 b). Donnelly (2010: 1, 240) post-crisis characterised an “ongoing constitutionalization of Europe”, within the EU’s vertical and horizontal relationship, with a mix of EU and member state institutions and procedures, legitimate national variations in economic and social policy, a single integrated market, a bottom-up norm formation approach at two levels EU-member state and member state-the market, and three policy regimes for companies, financial markets and accounting standards.

4. International Financial Regulation: Post-Crisis: EU Context

A quickening "tide of global economic regulation", with the probable strengthening of the G20 Summit system has been anticipated, because rapidly increasing cross-border activity is causing the creation of an ever-increasing number of global economic regulatory systems (Eaker 2010). The Financial Stability Board (FSB),[3] now with the EU Commission as a member, replete with charter, chair, secretariat and steering committee issued a financial reform progress report extolling the need for peer review of countries standards and policies, which contained the following stern warning:

> Recognising that regulations must be nationally appropriate, they also will need to be internationally consistent. As experience shows, in a financially globalised world, uneven regulations across borders will inevitably lead to regulatory arbitrage and defeat of our common regulatory objectives.
>
> (FSB Report 2010: introduction)

The EU Commission, reflecting the need for sanctions, issued a policy statement concerning regulating financial services, geared towards financial growth, which incorporated the following view:

> A well-functioning internal market for financial services presupposes stringent, efficient and harmonised rules for all operators, coupled with an effective supervisory framework, strong, dissuasive sanctions and clear enforcement mechanisms. The proposed new supervisory architecture will provide the backbone for reinforced cooperation and a more harmonised, European supervision, allowing a holistic supervisory view, including of macro-economic factors. Once up and running the new European Supervisory Authorities will be instrumental in developing technical standards, creating a real Single Rule Book. (EU Policy Statement 2-06-10)

The five major pre-crisis EU financial regulatory objectives – the creation of an integrated EU financial space; the pursuit of financial stability; the availability of adequate financing to both public and private sectors to meet economic and social policies; investor protection; and, maintaining orderly markets – were impacted by assorted issues including:

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[3] Established by the then G7 group of nations on the 20th February 1999, and broadened by the G20 group at the London Summit on the 2nd April, 2009.

identified systemic risk (especially in the banking sector), the behaviour of certain market actors including hedge funds and ratings agencies, deficient risk management models used by financial institutions, liquidity provision problems and the lack of resolution capability (Wymeersch 2011: 445).

Reforms have been directed towards these issues. We examine a select few, new EU institutions and structures, the separate new EU and Irish mechanisms, and statements portending increased EU-led financial regulatory enforcement.

5. New EU Institutions and Structures

The EU system of governance, where economic motivations are prevalent, is the most developed and progressive transnational system in the world (Levi-Faur 2010: 23). The rise of EU regulatory agencies, and the expansion and institutionalisation of EU regulatory networks which include national regulators, in part due to increased Europeanisation, liberalisation and market integration are a central part of the multi-level EU system (Levi-Faur 2010: 2, 23; Craig & de Burca 2011: 3). The pre-crisis aim of such regulatory agencies and networks governance in the financial sector was to build a pan-European supervisory culture by fostering supervisory and enforcement convergence (Moloney 2010: 452). It failed. Post-crisis changes and reforms were thus needed with an enhanced enforcement capacity.

Writing from a UK financial regulatory viewpoint, mirrored in EU developments, Black (2010: 127) states:

> The crisis has also led to the creation of novel and challenging roles for the state, and the creation of a bespoke administrative apparatus to manage them.

Effective 1st January 2011 therefore, and as a direct result of the GFC, the EU re-organised its system of financial regulation (rule-making) and supervision (rule application) by installing four new bodies (EU Regulations 1092-1095/2010).

Firstly, a new constitutional layer in the form of a supranational systemic early warning board or council (ESRB) also replicated in the US (Dodd-Frank reforms), geared towards filling a gap perceived mid-crisis namely effective analysis of systemic risks and ensuring interaction with prudential supervisors (Wymeersch 2011: 450).

Secondly, three re-vamped supervisory watch-dogs or authorities which are underpinned by networks which include national regulators.[4] These new supervisory authorities have power to prepare common and legally binding regulations (effectively expert-led norm establishment) and the legal right to verify rule implementation/convergence in Member States as regards both the statute book and national practice (Wymeersch 2011: 449, 454). They are tasked to cooperate with the ESRB with the objective of establishing cross-sectoral joint positions and consistency (Wymeersch 2011: 451).

The powers invested in the three authorities have in-built limitations and restrictions and cover five fields: Rule-making; implementing EU Law; emergency powers where directed by the Council; conflict resolution of cross-border regulatory disagreements; and, restricting financial 'activities' (including products) at a macro level (Wymeersch 2011: 455).

However unlike the US where for instance the SEC or the CFTC have autonomous regulatory powers including enforcement powers, the actions of the new EU authorities must be based in EU Commission decision to be of legal force (Wymeersch 2011: 456); and in the case of implementation breach unless the non-compliant Member State adapts the required law or practice the EU Commission enforces under Article 258 TFEU (Wymeersch 2011: 459). In the case of financial institutions in breach however the relevant EU authority steps into the enforcement shoes of the national authority where required to maintain or restore neutral market competition conditions or to ensure the orderly functioning and integrity of the financial system (Wymeersch 2011: 459).

The system, a form of 'sectoral' regulation differing from the wider US approach, now consists of overlapping multiple regulators each responsible for its own defined area of banking, insurance and securities, while some fields remain unregulated (Wymeersch 2011: 443, 447). This new system reflects the unique style of EU 'federalism', where EU rules interact with—or limit—residual national competences, and where under the EU principle of subsidiarity regulation and supervision continue to be essentially a national matter, only moving to the EU level once EU rules have been adopted and enforcement is strictly necessary (Wymeersch 2011: 444).

National regulators form a large part of the three underpinning networks, and were often criticised for a lack of EU responsibility or EU mandate, and for basing their decisions on

[4] EBA-banking based in London, EIOPA-insurance & occupational pensions based in Frankfurt, and ESMA-securities & markets based in Paris replacing three earlier Lamfalussy Committees, respectively CEBS, CEIOPS and CESR.

national laws and interests (Wymeersch 2011: 444). One reform move has resulted in ESMA for instance being required to comply with the EU dictat: "The authority shall act independently and objectively in the interest of the Union alone" (EU Regulation 1095/2010).

Wymeersch (2011: 448) has criticised the complex nature of the EU financial regulatory institutional and structural capability as follows:

> "In theory at least, there are 3 × 27 regulators, without counting specialised bodies, such as the ones active in consumer protection, money laundering, takeovers and taxes, etc. To all this, the action of the central banks in the field of financial stability has to be added. The considerable inefficiencies caused by this state of affairs, leading to gaps and overlaps, to higher regulatory costs but also to different levels of investor protection, along with a continuing unlevel playing field and overall weak integration in some segments of the markets, are not in the best interests of Europe and its citizens. To a certain extent, confronted with worldwide (regulatory) competition, European markets are suffering from this weaker position".

In addition new EU 'bespoke' vehicles were established outside the strict EU ambit. This included the fire brigade EFSF and its permanent replacement the ESM both of which birthed from both political and economic contagion fears over both the euro and the union itself.

As a result of the sovereign debt crisis in Greece in May 2010[5] a joint EU-IMF-ECB stability fund was established. The EU portion or safety-net came in two jigsaw parts, first, a European Financial Stabilisation Mechanism (EFSM)[6] through which the EU Commission was allowed to borrow, in its own name, up to €60 billion for lending to member states in difficulties caused by exceptional circumstances beyond their control (EFSF Framework Agreement); and, second, the European Financial Stability Facility (EFSF).

The latter Facility is a temporary three year fund established outside strict EU ambit as a limited liability company, its shareholders being the Euro-zone member states.[7] Its role is to assist euro area member states in difficulty, with powers to borrow up to €440 billion under sovereign guarantee from euro-zone states[8] (EFSF Framework Agreement (Amendment) 2011 Annex 1 and EFSF website).

As Ireland suffered at the hands of the ruthless bond markets, from October 2010 onwards joint German-French proposals for a permanent rescue structure emerged and the EU

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[5] €80 billion Loan Facility Agreement 8th May 2010.

[6] Commencing with the European Council (ECOFIN) adopting Reg 407/2010) under Article 122 of the Treaty.

[7] It was decided upon by ECOFIN on the 9th May, 2010, established/incorporated on the 7th June 2010 in Luxembourg, and operative 4th August 2010.

[8] €780 billion originally guaranteed and now €726 billion after stepping-out by Greece, Ireland and Portugal.

Commission prepared their own proposals in early December. On the 17th December, 2010 EU Prime Ministers agreed at the Brussels Summit to create a permanent European Stability Mechanism (ESM) (Council Decision 2011/199). This effectively was designed to make the EFSF permanent, and was originally planned from 2013 but due to the escalating Euro-zone contagion brought forward to July 2012. Like the EFSF this permanent ESM fund will operate as an inter-governmental facility outside the ambit of EU institutions. Furthermore, the Brussels Summit added terms stipulating that the mechanism is a ‘last resort’ intervention for weakened euro-zone members; the granting of financial assistance is subject to strict ‘conditionality’; and, private sector bondholders must share the cost of any write-downs/haircuts.

Allied to the EFSF/ESM structure, stressed by the EU as an element of a global strategy to strengthen Economic and Monetary Union, the granting of assistance in the framework of new programs under the European Stability Mechanism will be conditional, as of 1 March 2013, on the ratification of the new EU Fiscal Treaty or Compact agreed on the 31st January, 2012 (recital Fiscal Treaty). This compact is an intergovernmental International Treaty also outside the strict EU ambit or Treaty architecture but contains a provision (art. 16) envisaging incorporation into the governing EU treaty within five years after “assessment of the experience with its implementation”.

Concerning the EU therefore, in essence reform actions have birthed from political and economic fears and have taken two forms. Firstly, the more measured De Larosiere recommended two-part institutional and structural reform which in part has built upon the previous Lamfalussy committee ideation. The overarching stability council is a creature reflected in best international practice as advocated at G20 level and replicated in the US. As to the three new authorities limitations remain, they differ from US-style competence especially in enforcement, and there is still much complexity. Secondly, lurching fire brigade mechanisms driven by contagion fears mainly outside of strict EU ambit, tailored to the ‘inner’ Euro-zone but impacting all Member States, which has seen a further two-piece construction for the provision of funds for sovereigns in need. These developments, often rapidly overtaking themselves, have come about by way of differing instruments and from differing sources. The EFSM a Council vehicle established by Regulation, the temporary EFSF an effective regional guaranteed treasury agency set up by two Framework Agreements, a morphing permanent ESM established by Heads of Government and grounded in a Treaty, and lastly, the Fiscal Compact married to the ESM negotiated by Heads of Government and set out in an intergovernmental Treaty and governed by a hybrid mechanism.

6. Ireland: Special Resolution Vehicles:

As part of the financial crisis response emergency Special Resolution Vehicles were created in many countries, including the UK and Ireland within the EU buttressing EU efforts. One world-wide survey carried out for the Bank of England and reported in July 2009 depicted such special resolution regimes as being characterised by public interest concerns, with objectives geared towards orderly resolution of bank failure and preservation of financial stability and confidence in the banking system; and in design being fundamentally different from corporate insolvency law; while implementation of resolution measures were generally under regulatory control, the rights of bank stakeholders were subordinated and compensation schemes were often not specified (Brierly 2009).

We will look at two regimes affecting Ireland as exemplars which both have an EU dimension. Neither example however comes under what may be termed 'regulatory control', although the rights of the Irish people generally and specifically taxpayers are clearly subordinated to a public interest concern expressed by a public choice policy methodology.

7. Ireland: Special Resolution Vehicles: Example NAMA

The National Asset Management Agency (NAMA), a unique and major institutional innovation, is a statutory special resolution regime, in reality a 'bad' property asset bank described by some as the world's largest property company, established on foot of an Irish government sponsored report to purchase an estimated €80-90 billion in 'toxic' development loans with a sizeable haircut, and which because it amounted to state aid received EU Commission approval in February, 2010 (Carswell 2010).

The Irish Supreme Court (Denham J in *Dellway*) has described NAMA as being fundamentally different from a bank; as not being licensed under Irish law to operate as a bank and as not operating in the same manner as a bank; NAMA instead is a work-out vehicle and any decision by it to acquire loans adversely affects borrower reputation.

In broad brush terms the regime has acquired property assets from five Irish domestic financial institutions since May 2010 at discounts sometimes in excess of 60% on face value, although some assets are located outside the Irish jurisdiction (67% of total Irish) such as the UK

(27%), US (3%), and Europe (3.5%). By December, 2010 NAMA had acquired eleven thousand loans whether good or bad totalling €71.2 billion at face value, but had only sold property worth €1.6 billion (Lynch 2010).

The grounding NAMA legislation was challenged in the Irish courts in the *Dellway* case by a property developer (*McKillen*), claiming his companies were not a systemic risk. However, he was originally unsuccessful in seeking to keep his still performing loan portfolio outside the NAMA ambit, despite employing Dr Joseph Stiglitz as an expert witness. At first instance the three judge divisional Irish High Court, whose decision was partly overturned on appeal because of unfair NAMA procedure in taking in the loans, made it clear that they took the view that the legislation was a proportionate response to a very grave financial situation. In a nutshell the High Court, which made it clear that it had no role in relation to the merits of NAMA, reiterated that in Ireland the government determines solutions large or small where the political process deems appropriate, whether by exercise of executive power or under existing or new constitutionally permissible legislation, the court role being confined to the interpretation and application of such legislation, and if relevant the application of EU law in the course of any such determination. In this case it was held *inter alia* that the NAMA legislation passed the judicially defined 'proportionality test', state interference with property rights of the individual citizen permissible where required by the exigencies of the common good.

In the Supreme Court on appeal Murray CJ delivering the judgment of the court highlighted that NAMA was established as a lawful policy choice by the Irish Oireachtas (Legislature) and that as a statutory agency it employed experts in the financial or banking sector to exercise key discretionary responsibility in asset acquisition. Fully supporting the political response to the financial crisis, and applying a strict 'legal formalism' approach, Murray CJ stressed that because public confidence, and particularly confidence in the finance or banking sector, "may be profoundly influenced by perception that it was entirely rational that the Oireachtas would provide for a broad definition of eligible bank asset to avoid any risk that any bank borrowings which posed a systemic risk to the economy and in particular the banking sector might be considered to fall outside the remit of the statutory provisions".

8. Ireland: EU-IMF Memorandum of Understanding: Example of EFSF role

Irish banks had been re-capitalised in late 2008, ‘public interest’ directors had been appointed to boards by the Irish government, and NAMA was acquiring toxic loans, while due to further re-capitalisation demands bank nationalisations in whole or part ensued. Amid this increasing soaking up of private debt, under circumstances where bank insolvency and not illiquidity became obvious, and where government finances rapidly deteriorated in a typical recession revenue loss and welfare explosion dyad leading to a massive budget deficit ten times above the 3% EMU limit within the ‘pegged’ Euro-zone, the bond markets exercised a harsh interest rate discipline forcing Ireland out of the market.

In November 2010 realising that Ireland was pivotal to stopping further financial market contagion, an ECB warning was raised, and a subsequent joint EU-IMF approach discussed at G20 level, was strong-armed on an Ireland plunged into a four year austerity plan and badly in need of rescue for both banking and sovereign needs. This resulted in the signing of a Memorandum of Understanding, which was approved by parliamentary vote (EU-IMF MOU 2010). Part of the €68 billion funds pledged came from the EU Commission and part from the newly created EFSF both garnering the funds from the bond markets, while other European countries including the UK, Denmark and Sweden offered bilateral terms. In a move hitherto unprecedented the rescue plan compelled the Irish government to implement fiscal responsibility legislation, introduce multi-annual expenditure ceilings, establish an independent budgetary advisory council, and in the face of UK concerns allowed for other EU member state involvement in both the design and implementation of a new liquidity assessment of Ireland’s financial institutions (Beesley 2010).

As far as Ireland is concerned, in essence these two responses were emergency measures which effectively enjoyed the same causation, the illiquid and insolvent banking sector. Both were purposed towards maintaining financial stability. While NAMA was grounded in an Irish Government sponsored report, the EU-IMF bailout was imposed from without due to wider EU contagion fears. Fortunately for Ireland the EU emergency structure was in place. Both were grounded in Irish legislation. The Irish judiciary have fully supported the NAMA emergency response as a community benefit overriding individual property rights but not procedural rights. Both were the creatures of public choice politics despite having massive financial and social implications for Irish citizens and especially taxpayers. In the case of NAMA there is some hope of a return on investment but not in the short-term. The running-sore of the Euro-zone crisis has brought about hard-negotiated bailout interest rate alleviation as some saving for Irish taxpayers, and perhaps softened Irish loss of fiscal sovereignty as now most of the EU has signed up to the

Compact. While emergency measures elsewhere have a limited life expectancy it appears both of these will enjoy a longer life span. There is no specific regulatory tool or agency with jurisdiction over either area. Indeed, NAMA is itself an agency and one with massive autonomy. Interestingly, the Compact which is married to the ESM is the subject of an Irish plebiscite (31st May 2012 - successful) in the face of constitutional challenge whereas the transfer of massive amounts of private debt to the sovereign and the signing of stringent austerity commitments is not.

9. Better EU Regulation and Enforcement

By way of overview, the driver of financial regulation in the EU from the 1999 FASP pre-crisis was political and economic – sealing market gaps – purposed towards convergence or harmonisation. Post-crisis the driver has been market failure with reform in mind but equally with heavy political and economic input. While beforehand the main elements were EU legislation transposed into national law, subsequent financial regulatory developments have mirrored global systemic risk or stability concerns and have centred as shown on new institutions and mechanisms, and enforcement.

In the US, similarly replete with conflicting political interests, infighting and patronage (Ridpath 2011: 2) there has been a tools, rules and institutions reform with detailed rule-making left to the regulatory experts (Dodd-Frank). This approach has been praised as enabling greater latitude for achieving congruence between EU and US regulatory reform (Ridpath 2011: 3). One example is the extensive meetings between the US SEC and the EU ESMA (and EU Commission) purposed towards agreeing key aspects of derivatives regulation, although all too often US and EU regulators seeking cooperation suffer a lack of similar levels of authority (Ridpath 2011: 3).

There have however been some other EU-US mirroring proposals: hedge fund registration; credit rating agency licensing, which is also an Australian reform recently approved by the EU; new stability boards or councils; in the US a new Consumer Protection body. There has also been some divergence: US regulators remain competitive and semi-autonomous; the EU system is more complex with regulatory networks prominent; EU ‘soft law’ enforcement contrasts ‘harder’ US approaches; the EU clearly lags behind the US at both national and EU level in the use of criminal sanctioning for enforcement purposes. If it is to occur at all, while rule-making for the supervision of an enforcement institution and/or the operation of enforcement actions must proceed at EU-US level, cooperation at EU Member State level will also be essential (Ridpath 2011: 3-4).

The EU reform road to 'speedy and effective' financial regulation can more recently be traced from 2007 when the financial crisis began to bite. In December, 2007 the EU Council invited the EU Commission to conduct a cross-sectoral stocktaking exercise of Member State sanctioning powers and regimes, which three years later in December, 2010 resulted in the publication of six identified divergences:

(a) Some competent authorities lack important types of sanctioning powers for certain violations;
(b) The levels of administrative pecuniary sanctions (fines) vary widely and are too low in some;
(c) Some competent authorities cannot address administrative sanctions to both natural and legal persons;
(d) Competent authorities do not take into account the same criteria in sanction application;
(e) Divergence exists in the nature (administrative or criminal) of sanctions provided;
(f) The level of application of sanctions varies.
(EU Com SEC (2010) 1496 final at p.3)

Hard on the heels of the 2009 de Larosiere Report (2009: 13-37) which also recommended the deployment of sanctioning regimes that are sufficiently convergent, strict, and resulting in deterrence, the EU Commission published a Roadmap (COM 2009/114) which specified that one of five key objectives was: more effective sanctions against market wrongdoing. In synchronised choreography, within two weeks the ECOFIN Council called for better regulation of financial markets (EU Com SEC (2010) 1496 final at p.3) and advocated rigorous enforcement of financial regulation and transparency, backed by effective, proportionate and dissuasive sanctions, in order to promote integrity in financial markets. Almost nine months later the EU Council emphasised the need to regulate financial markets and prevent market abuse (Stockholm Programme 2009). Six months further on in June, 2010 (COM (2010) 301 Final 2nd June 2010: 6), the EU Commission announced that enforcement of sanctions was largely un-harmonised leading to diverging practices among national supervisors, and declared that financial regulatory enforcement was one of four intrinsically linked reform pillars (COM June 2010: 4).

However in what perhaps amounts to a stark warning to EU legislators Moloney (2010: 454) has argued:

> “The burgeoning complexity of financial market risk, the pace of innovation, the blurring of financial sectors and regulatory boundaries, and the need for multi-layered regulatory strategies all reinforce the weaknesses of detailed static regulation and caution against a detailed, rule-based response”.

10. Conclusion

Changes in Irish and EU mechanisms and institutions amount to regulatory paradigm shifts – as do those in the US, all geared towards financial stability. Including a number of new special resolution innovations, they have impacted the institutionalised paradigm core with consequent power and organisational structure corrections. Regulatory gaps in authority and implementation hamper the EU-US regulatory dialogue. Marked political divergence around EU crisis response policy-making has emerged. Amid public interest motivation, greater use of public choice policy-making is evident. The Irish Supreme Court has adopted a ‘legal formalism’ approach in support of such policy-making. There has been increased use of hybrid mechanisms outside strict EU ambit. The new EU institutions are expected to both speed up, and provide better, norm convergence and integration, but the system is complex. Limitations upon the powers of the three new EU authorities may prove problematic. Significantly the Irish sovereign state (like Greece and Portugal) has itself become a regulated entity with a much damaged ‘sovereignty’. EU enforcement reform actions seemingly heralding a move from EU ‘soft law’ approaches to a ‘harder’ regime, including the increased use of the criminal law which has been advocated and indeed re-advocated many times, await clarification and implementation. They have thus far moved at snail’s pace with time-lags of years not unusual. Lack of convergence is a major issue. Opt-in stipulations by countries such as Ireland provide fertile ground for regulatory arbitrage and increase legislative complexity. There is little direct EU enforcement capability. Further, the use of detailed static regulation based around a detailed, rule-based response, if chosen, appears doomed to failure.

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