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A Norwegian Perspective on Soft Law in the Financial Supervisory Field

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# Binding Rules Through the Backdoor? A Norwegian Perspective on Soft Law in the Financial Supervisory Field

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# 1 Introduction

The role of soft law within the European Union (the EU) and the European Economic Area (the EEA) is not straight forward. Although Article 288 (5) of the Treaty on the Functioning of the European Union (the TFEU) clearly states that "Recommendations and opinions shall have no binding force", this primary law wording continues to be challenged. This is therefore not a new issue, but there have been recent developments that more clearly demonstrate how this denomination of rules as "non-binding" often becomes confusing and sometimes, I would argue, even incorrect. This is because in practice the rules have the opposite effect and become of a binding nature.

The denomination of binding rules through the backdoor is perhaps particularly accurate when it comes to describing the soft law procedure within the financial supervisory field, but from a broader perspective it is arguably also descriptive for how the procedure of non-legislative acts has turned out to be used within this field. In this article I seek to explain the legal mechanisms that create such legal effects and highlight some legal challenges such a system creates, from a Norwegian perspective.

## *1.1 EU Expansion*

During the last decades we have witnessed a growing EU public law administration. This development has naturally had an impact on national public administrations and the interaction between the EU administration and national administrations throughout Member States. Some call this development an "agencification" within the EU, referring to the growing number of EU agencies located both in Brussels and across Europe. These agencies have no common primary law legal basis for their authority and are therefore distinct from other EU institutions.[1] Still, common for them all is that they constitute expert organs within their fields, providing the European Commission (the Commission) with expert assistance. They often monitor, in close collaboration with public national enforcers, different specialized branches of the public sector. The collaboration between the Commission, the agencies and national public administration varies, however, depending on the sector. The agencies oversee different tasks, and they have different mandates and authorities when it comes to technical, scientific or administrative tasks.[2] Because these expert areas often develop and change fast, there is a need for dynamic rules. Soft laws are therefore often used because they escape the more time-consuming ordinary legislative procedure pursuant to

[1] The authority of agencies is subject to the Meroni doctrine, established through case law in Case 9/56. This has become a controversial doctrine, but I will not discuss this debate in this article. Briefly explained, the doctrine limits the delegatee's authority, in this scenario meaning that agencies, when delegated authority from the Commission, are limited from holding any discretionary powers since this is considered to disturb the institutional balance.

[2] For a rough overview of the assignments of EU agencies, see this webpage https://eur-lex.europa.eu/EN/legal-content/glossary/european-union-agencies.html [last accessed 21/10-2024]. For more information about the different agencies, this is found on the EU Agencies Network's webpage available here https://agencies-network.europa.eu/index_en [last accessed 21/10-2024].

Articles 289 and 294 TFEU, and thus constitute efficient legislative tools to tackle these fast-moving markets.

Within the financial supervisory field, the European Supervisory Authorities (the ESAs)—consisting of the European Securities and Market Authority (ESMA), the European Insurance and Pension Authority (EIOPA) and the European Banking Authority (EBA) – hold the power to issue such soft laws pursuant to Regulation No 1093, No 1094 and No 1095/2010 ("the Founding Regulations").[3] They therefore do not only hold the powers as administrative executive organs, but they also hold legislative powers. To briefly summarize the ESA's

powers that are enshrined in the Founding Regulations, their regulatory powers consist of drafting two types of technical standards—regulatory technical standards and implementing technical standards—which are adopted by the Commission as delegated or implementing acts. They issue guidelines and recommendations to safeguard a unified supervisory system. Lastly, they have certain powers in cases of breaches of EU law by national supervisory authorities, emergencies and disagreements between competent national authorities. This means that the ESAs have a limited quasi-rule making authority, have some direct supervisory responsibilities (e.g. ESMA directly supervises credit rating agencies) and are responsible for coordinating the consistent application of EU law by the competent authorities and mediating between them. In the recital of the Founding Regulations, these powers are justified because they enable each ESA "to fulfil its objectives" which is why "the Authority should have legal personality as well as administrative and financial autonomy".[4] I will limit the following analyses to the "legal personality" and explain more about this below. Before elaborating further on the role of soft laws within the financial supervisory field, which has its main legal basis in Article 16 of the Founding Regulations it is, however, necessary to briefly explain in more general terms what soft law is within the EU regulatory landscape.

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[3] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC [2010] OJ L 331/12 (Regulation 1093/2010 or the Founding Regulations). Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC [2010] OJ L 331/48 (Regulation 1094/2010 or the Founding Regulations). Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L 331/84 (Regulation 1095/2010 or the Founding Regulations). "The European System of Financial Supervision is a multi-layered system of micro- and macro-prudential authorities that aims to ensure consistent and coherent financial supervision in the EU. It includes the European Systemic Risk Board, the three European supervisory authorities (EBA, ESMA and EIOPA) and the national supervisors. The European Central Bank, as part of the Single Supervisory Mechanism (SSM), is the banking supervisor for the largest banks.", see https://www.europarl.europa.eu/factsheets/en/sheet/84/european-system-of-financial-supervision-esfs- [last accessed 21/10-2024].

[4] Recitals 13 of Regulation 1093, - and 1094/2010, and recital 14 of Regulation 1095/2010.

### *1.2 What is Soft Law?*

At the outset, an important disclaimer is that other than the characteristics of the non-binding nature of recommendations and opinions in Article 288 TFEU, there are no common characteristics found in primary law about the broad range of soft law instruments, such as notices, communications and guidelines, to mention a few. I will not go into detail about all the different types of soft laws, but rather mention a few characteristics that are common and defining for this group of legal acts. Of emphasis for this article is the role of guidelines and recommendations within the financial supervisory field which are the soft laws referred to in Article 16 of the Founding Regulations.

Firstly, soft laws are not independent legal acts.[5] By this I mean that a soft law is always connected to an existing or forthcoming hard law, which can be either primary or secondary legislation. This means that the role of soft laws is defined by the connection it has to this primary or secondary legislation, and hence a soft law instrument never operates on its own.[6] A soft law can thus never be fully comprehended in isolation since its existence depends on the connection to a hard law. This connection, however, varies in terms of the degree of dependence: A guideline on how to interpret a legal act is more closely connected to the hard law than soft laws such as a notice on how to operate an enforcement tool.[7] These examples demonstrate the broad range of legal instruments gathered under the umbrella of "soft laws". Although all of them connect to a hard law, their different roles and degree of dependence may be confusing at times, notably giving rise to the question as to why some of them are not enshrined into hard law. This takes me to another common characteristic of soft laws.

Soft laws often play an important role as policy instruments and are an expedient manner for the EU to achieve policy goals throughout Member States with lesser means than traditional legislation. By removing barriers within the internal market more rapidly, they are often used to achieve a unified legal approach throughout Member States.

Returning to the characteristic already referred to about the non-binding nature of soft laws, what this more specifically entails is that on its own, it can never impose a legal obligation for public or private bodies, nor a legal right directly enforceable in front of the courts. This is at least the starting point. As my analyses below will demonstrate, however, this may not be as straightforward within the financial supervisory field.

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[5] There are exceptions, such as informative communications from the Commission to the Parliament and the Council. These communications often remind more of political than legal documents, and do not indicate a legal basis on which they are founded, and the Commission does not follow any specific procedure to adopt them.

[6] That soft laws never operates on their own is exemplified well through ESMA's overview of its guidelines where the "overarching directive or regulation" (see to the left of the excel sheet) is always referred to guidelines_tracker.xlsx [last accessed 21/10-2024].

[7] An example of such a guideline is ESMA's Guidelines on key concepts of the Alternative Investments Funds Directive [2013] ESMA/2013/600 (AIFMD). An example of such a notice is the Commission Notice on Immunity from fines and reduction of fines in cartel cases [2006] OJ C 298/17.

Despite these common characteristics, the legal nature, function, and status of the broad range of soft law instruments remain divergent and at times unclear. Even if soft laws have a long-standing tradition within EU law, their initial non-binding nature has several times been challenged in front of the Court of Justice of the European Union (the CJEU).[8] Although never declared binding, the CJEU has several times ruled that soft law instruments must be taken into consideration when interpreting hard law.[9] There have also been cases on how to deal with the legal nature of soft law instruments in legal procedures within the financial supervisory field.[10]

Even if the CJEU never has declared that a soft law instrument must be complied with, in practice both national authorities and financial institutions within the financial markets are faced with a different reality.[11] From a Norwegian perspective as an EEA/EFTA-state there are some peculiar issues as well. I will elaborate on these matters in the following parts 2 and 3.

## 2 Soft Law within the Financial Supervisory Field

### *2.1 The Emergence of the European System of Financial Supervision*

In order to understand the regulatory system within the financial markets of Europe today, it is necessary with a brief recap of the background for why and how such a system emerged.

The global financial crisis back in 2007 and 2008 revealed several weaknesses within the financial supervisory system in Europe. The need for a more robust, integrated financial market in the EU had, however, already been called for a few years earlier.[12] The weaknesses identified throughout this decade concerned both the regulatory – as well as the supervisory systems.[13] Without

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[8] There are several cases dealing with these issues, such as Case C-322/88 Salvatore Grimaldi v Fonds des maladies professionnelles [1989] EU:C:1989:646 (*Grimaldi)*, Case C-428/14 DHL Express (Italy) Srl, DHL Global Forwarding (Italy) SpA v Autorità Garante della Concorrenza e del Mercato [2016] EU:C:2016:27 (*DHL Express)*, Case C-501/18 BT v Balgarska Narodna Banka [2021] EU:C:2021:249 (*BT)*, and Case C-911/19 Fédération bancaire française (FBF) v Autorité de contrôle prudentiel et de résolution (ACPR) [2021] EU:C:2021:599 (*FBF*).

[9] Case C-322/88 *Grimaldi*, Case C-428/14 *DHL Express* and Case C-501/18 *BT*.

[10] See C-4501/18 *BT* and Case C-911/19 *FBF* about inter alia preliminary rulings and soft laws.

[11] Advocate General Bobek touches upon this in Case C-911/19 Fédération bancaire française (FBF) v Autorité de contrôle prudentiel et de résolution (ACPR) [2021] EU:C:2021:599 (*FBF*), Opinion of AG Bobek, paras 54 and 55.

[12] In the Lamfalussy report from 2001 it was already stated that "the European Union's current regulatory framework is too slow, too rigid, complex and ill-adapted to the pace of global financial market change", see the Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (the Lamfalussy report), chaired by Alexandre Lamfalussy [2001], p. 7.

[13] Whereas the Lamfalussy report focused on regulatory improvements, the Report of the High-Level Group on Financial Supervision in the EU (the Larosière report), chaired by Jacques de Larosière [2009] focused on how to improve the supervisory systems. Both these reports were paramount in the establishment of both the regulatory – and supervisory systems of the financial markets today.

going into detail about the macro and micro economic aspects,[14] from a legal perspective what was called for in order to handle these weaknesses was more harmonized rules,[15] as well as rebuilding a new EU supervisory apparatus and closer collaboration between supervisory authorities on the EU and national levels. The Founding Regulations of 2010 therefore established the European System of Financial Supervision (ESFS), which provides the ESAs with their supervisory as well as legislative powers they have today. Perhaps most importantly, the Founding Regulations united the national supervisory authorities' (NSAs) around their mandate as daily supervisors of the financial markets in Europe, pursuing the interests of the EU.[16]

It is, however, not the mandates of the national supervisors that are under scrutiny in this article, but rather the legislative powers of the ESAs, and more specifically the authority to issue recommendations and guidelines pursuant to Article 16 of the Founding Regulations. To draw up a rough picture of why the ESAs have been given such legislative powers, a natural starting point is the main objective of the ESFS of which the ESAs are part. In Article 2 of the Founding Regulations it is stated that the main objective of the ESFS is "to ensure that the rules applicable to the financial sector are adequately implemented to preserve financial stability and to ensure confidence in the financial system as a whole and effective and sufficient protection for the customers of financial services".[17] The objective of the ESAs is more specifically outlined in Article 1 where it follows that the objective of the ESAs shall be "to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses".

To contribute to achieve these overarching objectives, Chapter II of the Founding Regulations outlines (a long list) of tasks and powers of the ESAs. Here two of the legislative powers of the ESAs are enshrined: 1. The power to initiate and draft regulatory and implementing technical standards. 2. The power to issue guidelines and recommendations. Adding to these two explicit powers is perhaps the most important, but less visible legislative influence of the ESAs since it is not explicitly provided for in the Founding Regulations. This power is the advisory function of the ESAs when the Commission adopts delegated or implementing acts on its own initiative that are not considered technical standards.[18] These are often made up by what is commonly referred to as "Commission regulations" or "Commission directives", as opposed to "EU regulations" or "EU directives" that have to go through the traditional legislative procedure adopted by the Council and the Parliament. Before zooming in on

[14] For more about this, see https://www.europarl.europa.eu/factsheets/en/sheet/84/european-system-of-financial-supervision-esfs- [last accessed 21/10-2024].

[15] See inter alia the Larosière report p. 29. See also Report from the Commission to the European Parliament and the Council. On the operation of the European Supervisory Authorities (ESAs), COM [2022] 228 final, p. 14.

[16] See inter alia recitals 8 and 9 of the Founding Regulations.

[17] Wording from revised version 30/12/2024.

[18] For more about this see https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2016/09/the-eu-legislative-process-explained.pdf [last accessed 21/10-2024].

point 2, I will briefly explain what the ESAs' powers are concerning the hard laws of technical standards, and delegated and implementing acts more generally, in the following subchapter.

### *2.2 The Rubber Stamping of the Commission*

To explain the ESA's power to initiate and draft regulatory and implementing technical standards within the financial supervisory field and their advisory function when the Commission initiates level 2 acts, we must start within the primary legislation, more specifically Articles 290 and 291 of the TFEU. Note that delegated and implementing acts are referred to as "non-legislative acts" within the EU (see inter alia Article 290 TFEU), as opposed to "legislative acts" having gone through the traditional legislative procedure. Within the financial supervisory field, the non-legislative acts are referred to as level 2 acts, whereas directives, regulations and decisions adopted by the Council and the Parliament are referred to as level 1 acts, inspired by the regulatory level system introduced in the Lamfalussy report.[19] Through these primary law provisions, the Council and the Parliament can delegate certain legislative powers to the Commission that are exempted from the traditional legislative procedure.[20] The wording of these provisions clearly limits the holder of such delegated powers to "the Commission", which is important to take note of. Other bodies, such as the ESAs, cannot be delegated such powers.

However, within the financial supervisory field, Articles 10 and 15 of the Founding Regulations provides the ESAs with powers to initiate and draft regulatory and implementing technical standards, respectively, for the Commission to adopt or in practice "rubber stamp", while keeping the Council and the Parliament informed about their legislative works.[21] In recital 22 of the Founding Regulations it is stated that Commission amendments should take place "only in very restricted and extraordinary circumstances" and never "without prior coordination with the Authority", the latter requirement also stipulated in Articles 10 and 15 of the Founding Regulations.[22] It is the ESAs that are the expert organs, and these types of acts require a level of expertise within the specific sector which the Commission does not possess on its own. That is why the formal adoption of these acts by the Commission have been referred to as rubber stamping since the Commission often does not hold the competence to amend the content of these technical standards.

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19 I will not elaborate more about the level system in this article.

20 In Article 290 TFEU these legislative powers are specified to be "the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act".

21 As touched upon in the introduction, the procedures for adopting these acts are a compromise between the need for more efficient decision-making on the one hand, and a desire by the Council and Parliament to preserve some influence over Commission decisions on the other hand.

22 The circumstances for when such amendments will take place are specified in the same recital to be when "incompatible with Union law, did not respect the principle of proportionality or ran counter to the fundamental principles of the internal market for financial services as reflected in the *acquis* of Union financial services legislation".

The need for the ESAs expertise is also strong for level 2 acts outside of what falls within "technical standards". To me, the borderline between what is considered technical standards and what is not is unclear, but I will not discuss this further in this article. Roughly explained, delegated acts of the Commission have as their primary aim to "flesh out" the content of level 1 legal acts. i.e. regulations, directives and decisions adopted by the Council and Parliament. Implementing legal acts serve to safeguard the uniform application of level 1 acts. Regulatory and implementing technical standards can be considered a subcategory and have similar aims, but on an even more detailed and complex level, which is why the ESAs as expert organs are provided with a right of initiative to draft them.[23] The procedure for adopting these technical standards follows from the Founding Regulations, making them in this sense unique for the financial supervisory field.[24]

Within the financial supervisory field, the technical standards are required to be adopted by means of regulations or decisions pursuant to Articles 10 and 15 of the Founding Regulations. The increase in notably Commission regulations and use of soft laws within the financial supervisory field is part of what I refer to as a regulatory shift. What I call binding rules through the backdoor is part of this shift. I will return to this after having explained the ESA's regulatory power to issue recommendations and guidelines.

### *2.3 Broad Powers to Issue Soft Laws*

To pick up where we left in the previous subchapter, it follows from recital 26 of the Founding Regulations that "(i)n areas not covered by regulatory or implementing technical standards, the Authority should have the power to issue guidelines and recommendations on the application of Union law". This wording gives the impression that the use of soft laws within the financial supervisory field is considered the second-best option or a safety net when the adoption of hard laws is not possible. This may be true in some instances, but if we examine the wording of Article 8 of the Founding Regulations, we see that the use of guidelines and recommendations are listed as equal tools when it comes to achieving the aims of the ESFS. Here it is stated that to contribute to "the establishment of high-quality common regulatory and supervisory standards and

[23] Article 521 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176/1 (the Capital Requirements Regulation) provides a good example of how it shall be supplemented with drafted technical standards and adopted delegated and implemented acts. Here it is inter alia stated that: "This Regulation shall apply from 1 January 2014, with the exception of … c) the provisions of this Regulation that require the ESAs to submit to the Commission draft technical standards and the provisions of this Regulation that empower the Commission to adopt delegated acts or implemented acts, which shall apply from 31 December 2014".

[24] There are, however, several agencies that hold similar drafting powers, such as the European Railway Agency (ERA). For more about this see Edoardo Chiti, "European Agencies' Rulemaking: Powers, Procedures and Assessment" [2013] European Law Journal, Vol. 19 No. 1, pp. 93–110. See also M Van Rijsbergen,"On the Enforceability of EU Agencies' Soft Law at the National Level: The Case of the European Securities and Markets Authority" [2014] Utrecht Law Review, Volume 10, Issue 5.

practices" the ESAs shall have the powers to develop "draft regulatory and implementing technical standards, guidelines, recommendations, and other measures, including opinions".

The procedure for the issuing of guidelines and recommendations follows from Article 16 of the Founding Regulations. Here, the aims of Article 8 are reiterated in a more elaborate writing, making it easier to identify two objectives of issuing soft laws: 1. "(E)stablishing consistent, efficient and effective supervisory practices within the ESFS." 2. "(E)nsuring the common, uniform and consistent application of Union law." Although more elaborate, the wording is still very broad. I will not delve too much into the content of this wording in this article other than emphasizing that the wording does constitute (a vague) framework or limit for when the ESAs have been provided powers to issue these soft law instruments. This means that guidelines and recommendations not pursuing these aims are to be considered ultra vires.[25]

The main take-away of relevance for this article is, however, that the broad wording means that the ESAs initially have been provided broad powers to use these regulatory tools. It is important to stress, however, that case law has demonstrated that these broad powers do not entail that the ESAs have been given free rein when it comes to the issuing of soft laws. In *FBF* the CJEU thoroughly scrutinized some guidelines on the governance of retail banking products.[26] The Court scrutinized the guidelines pursuant to a two-step test, starting out with the overall regulatory framework referred to in Article 1 (2) and (3) of the Founding Regulation of EBA, closely examining the guidelines in light of the relevant EU Directives listed there. The Court then went on to examine the guidelines taking into consideration the objectives listed in the specific framework referred to in Articles 1(5), 8 and 16 of the Founding Regulation of EBA.[27]

In the same case the Court argued that the comply or explain-mechanism of Article 16 demonstrated the non-binding nature of the contested guidelines.[28] I believe there are reasons to challenge the Court's stand on this matter, which brings me back to what I call binding rules through the back door. To explain this further, we first need to dive into this comply or explain mechanism outlined in Article 16.

### *2.4 Comply or Explain – the Nudge Towards Bindingness*

The initial questions that arise are what this comply or explain-mechanism entails, and who it is directed at. In Article 16 (3) it is stated that "the competent authorities (mainly the NSAs) and financial market participants shall make every effort to comply with ... guidelines and recommendations". It further follows

[25] See Case C-911/19 *FBF* where EBA's authority to issue guidelines was challenged in the French courts, paras. 67, 72 and 75.

[26] A more specific reference to the contested guidelines is the Guidelines of the European Banking Authority (EBA) of 22 March [2016] on product oversight and governance arrangements for retail banking products (EBA/GL/2015/18).

[27] Case C-911/19 *FBF*, paras 66-130.

[28] Case C-911/19 *FBF*, paras 42-46.

from the same paragraph that within a set time limit (two months) from the issuance of a guideline or recommendation, each NSA needs to confirm whether it will comply with the soft law. If explicitly provided in a guideline or recommendation, the same obligation applies to financial market participants.

The strong encouragement to comply with the rules is directed towards both national authorities as well as financial institutions in the financial markets. The requirement to inform the ESA about compliance only applies to financial institutions if explicitly provided for.

It further follows from the wording that an NSA shall inform the relevant ESA of non-compliance and state the reasons for it. This obligation only applies to the NSAs. Lastly, the ESA shall publish the non-compliance of an NSA and it may decide on a case by case basis to publish the NSA's reasons for non-compliance.[29] The NSA shall receive notice if its reasons are to be published. In recital 26 it is stated that the aim of having the possibility to publish is "to ensure transparency and to strengthen compliance by national supervisory authorities with those guidelines and recommendations".

From the wording it seems like the positive obligations of compliance largely apply to both NSAs and financial institutions, whereas the negative obligations of non-compliance are limited to the NSAs, in addition to the publication of non-compliance and the reasons for it. I have not found any explanations for this. If read in conjunction with Article 16 (1) where it is stated that the ESAs shall issue "guidelines addressed to all competent authorities *or* all financial market participants and issue recommendations to one or more competent authorities *or* to one or more financial market participants" (my emphases), this may entail different requirements depending on the addressees. If a guideline or recommendation is only directed at financial institutions, does this mean that the ESAs have less surveillance powers? Interesting to mention in this regard is the surveillance powers of the ESAs against NCAs and financial institutions in situations of non-compliance with *hard* law obligations. It follows from Article 17 (4) that in a situation of hard law non-compliance from an NCA, the ESAs may "adopt an individual decision addressed to a financial market participant requiring the necessary action to comply with its obligations under Union law including the cessation of any practice". In other words, the ESAs have the powers if necessary to adopt binding compliance – and cessation decisions against financial institutions, sidelining the NSAs where they do not comply with hard law obligations.[30] Although the enforcement powers of the ESAs become blurrier in the field of soft laws, this demonstrates that NSAs and financial institutions are considered two separate addresses under Article 16. This brings me to the regulatory shift within the financial supervisory field of binding rules through the back door. The challenges such a shift creates may not be so obvious from an EU perspective. From the point of views of the NSAs and perhaps

[29] For an example of reporting of non-compliance, see ESMA34-32-898, Compliance table on Guidelines on Article 25 of the AIFMD. ESMA's compliance tables may be found here https://www.esma.europa.eu/databases-library/esma-library?f%5B0%5D=basic_section%3A35&page=0 [last accessed 21/10-2024].

[30] See also Niamh Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market – A Tale of Two Competences: Part (1) Rule-Making' (2011) 12 European Business Organization Law Review 41, pp. 65-66.

notably the financial institutions, however, they are faced with several challenges due to this regulatory development.

As mentioned, the Court referred to the comply and explain mechanism as demonstrating the non-binding nature of a guidelines in *FBF*. From the perspective of the EU, I agree with this line of reasoning. To obtain the objective of creating an integrated financial market, it is understandable that the ESAs encourage and more importantly expect NSAs and financial institutions to comply with the rules. This is the "name of the game": Access to the financial markets of Europe requires that those operating there follow the same rules, and it is natural that the ESAs want to keep an overview for surveillance and regulatory purposes of those NSAs and financial institutions who do comply and those who do not, and the reasons for non-compliance.

If we change the perspective to that of the NSAs and the financial institutions, however, the regulatory landscape changes. Undoubtedly, the comply or explain mechanism nudge NSAs and financial institutions to comply. That is in the nature of such a mechanism, creating what I refer to as the nudge towards bindingness and binding rules through the backdoor, providing the guidelines and recommendations with a stronger legal force than what it initially was meant to have pursuant to Article 288 TFEU.[31] For the financial institutions, this sense of bindingness may be even stronger: A soft law instrument may be initially directed at the NSAs as enforcers, but the financial institutions are the real addressees of the guidelines. In such a scenario the financial institutions do not even have a say in the comply or explain-mechanism.[32] I find General Advocate Bobek's description of this phenomenon in his Opinion in *FSF* to be accurate:

> … what may perhaps still be construed as soft law when looking only and exclusively at the EBA and the competent national authorities becomes something very different one level down within the Member States. At that level, 'soft law' is 'no longer so soft', or may even turn into proper 'hard law'. It should be pointed out that EU law certainly does not preclude that from happening. Quite to the contrary in fact: the entire system is designed to function in precisely that way.[33]

## 3 The Backdoor Issue Does Not Only Concern Soft Laws

My intention in this article is not to question the importance of an integrated financial market. Rather, I question the regulatory means used to achieve such a market and the legal foundation for it. The denomination of binding rules through the backdoor is perhaps particularly accurate when it comes to describing the soft law procedure within the financial supervisory field, but from a broader perspective it is arguably also descriptive for how the procedure of non-legislative acts has turned out to be used within the financial supervisory field. Key to understanding this is the *extent* to which such procedures are used.

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[31] For an example of the low numbers of non-compliance, see Annex 1 of ESMA's Annual Report from [2022], p. 83 https://www.esma.europa.eu/sites/default/files/2023-06/ESMA_annual_report_2022.pdf [last accesed 17/8-2024].

[32] Case C-911/19 *FBF*, Opinion of AG Bobek, para 48.

[33] Case C-911/19 *FBF*, Opinion of AG Bobek, para 54.

How these procedures are used within the financial supervisory field creates several challenges. In the following I will address a few of these, starting with raising the question of whether the use of the soft laws and delegated and implementing procedures of the Commission within the financial supervisory field poses a threat to its democratic foundation. Note that several of the issues I address are not unique for the financial supervisory field but have relevance across several sectors within EU administrative law.

### *3.1 Legitimacy of the Regulatory System Within the Financial Supervisory Field*

An important disclaimer when discussing the legitimacy of the regulatory system and more specifically the Commission's secondary law procedures within the financial supervisory field, is to distinguish between the legal bases for these procedures and the use of them. As explained above, the regulatory powers of the ESAs together with the Commission have their legal bases within the TFEU and the Founding Regulations. If used in line with their aims, the legal foundations are thus in place. The issue I want to raise, however, is whether the extent to which these procedures are used and their roles at times move beyond their aims and hence these procedures become a shortcut to escape the traditional legislative procedure. If so, I argue that the regulatory system within the financial supervisory field poses a threat to the legitimacy and democratic foundation of such procedures.

If we examine the numbers of Commission Regulations and Directives these have outnumbered the EU Directives and Regulations by far.[34] This is also the case within the financial supervisory field.[35] If we zoom in on the regulatory powers of the ESAs we also see that there are hundreds of guidelines, recommendations and drafted technical standards, and we know that the number of these acts is set to increase.[36]

In these procedures, democratic control through Parliament is set aside. This is not an issue if the procedures are true to their aims contributing to "better regulation",[37] but when soft laws become of a binding nature and EU regulations and directives merely become a blank canvas for the delegated, implementing acts and technical standards to fill, I find that the regulatory procedures are moving into dangerous territory and are coming through the back door. Not only does this undermine why there is a traditional legislative procedure, it also poses a threat for the NSAs' functioning as daily supervisors of the financial markets in line with the EU rules. Lastly, the effective judicial protection of the financial

[34] For a general overview, see the statistics at EUR-Lex here https://eur-lex.europa.eu/statistics/2023/legislative-acts-statistics.html [last accessed 21/10-2024].

[35] See Overview Level 2 legislative measures in the area of financial services from [2019] here https://finance.ec.europa.eu/document/download/376ca8f0-00e3-4de3-9b0e-abdc1bb8b27a_en?filename=overview-table-level-2-measures_en.pdf [last accessed 21/10-2024].

[36] See for instance ESMA's library here https://www.esma.europa.eu/databases-library/esma-library?f%5B0%5D=basic_%3A365 [last accessed 21/10-2024].

[37] See https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation_en [last accessed 21/10-2024].

institutions is at risk when the regulatory landscape grows too fast to keep track of the rules. I will elaborate on these issues in the next two subchapters.

### *3.2 Implementation – and Surveillance Challenges for National Legislators and NSAs*

Taking into consideration the numbers referred to in subchapter 3.1, for national legislators and NSAs, keeping up to speed about the regulatory landscape within the financial supervisory field is challenging. A small comfort, on the one hand, for the national legislators may be the move towards more Commission regulations at the expense of directives since these are directly applicable pursuant to Article 288 TFEU.[38] For the NSAs, on the other hand, the development towards more detailed rules coming from the EU is difficult to navigate. And even if an EU directive was to be adopted, which initially pursuant to Article 288 TFEU is only binding as to the result to be achieved and thus provides the Member State with more regulatory flexibility, the increase in Commission amending regulations and directives, as well as soft laws by the ESAs, waters out the aim of choosing a directive as a legal act as opposed to a regulation.[39] For the national legislators this means that they still have to keep track and implement the rules coming from the EU and if necessary adjust national legislation, and NSAs remains faced with the task of navigating through a complex regulatory landscape.

### *3.3 The Implementation Challenges of Norway as an EEA/EFTA-state and the Struggle for the Norwegian Legislators and NSA*

Norway is not a member of the EU but is connected to the internal market through the EEA Agreement, which is considered a public international agreement with a few supranational traits.[40] This means that for EU legislation to be considered EEA law, it must be made part of the EEA agreement.[41] In addition, Norway has a dualist international law system, which means that for EEA law to become applicable it must be made part of our national law through the assigned legislative process. Pursuant to Article 7 of the EEA Agreement,

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38 For more about this, see Carl Fredrik Bergström, "EU Rulemaking in the Internal Market after the Financial Crisis" in Carl Fredrik Bergstrøm and Magne Strand (editors), "Legal Accountability in EU Markets for Financial Instruments: The Dual Role of Investment Firms" (Oxford Academic 2022).

39 I allow myself to merely refer to the EU secondary legislation on financial services, where this is seen several places. About the blurry lines between the functioning of different secondary law tools, see Case C-911/19 *FBF*, Opinion of AG Bobek, para 48 where he argues that the contested guidelines closely resemble directives.

40 E-9/97 Erla María Svenbjörnsdóttir v Iceland, Advisory Opinion of the EFTA Court of 10 December [1998].

41 EEA relevant binding secondary legislation is made part of the agreement's protocols and annexes through the formal decision of the EEA Joint Committee consisting of representatives from both the EEA/EFTA-pillar and the EU https://www.efta.int/eea-relations-eu/eea-institutions-two-pillar-structure/eea-joint-committee [last accessed 21/10-2024]. I will not elaborate on the stages of how EU law becomes EEA law in this article.

regulations and directives are to be made part of the internal legal order in the same manner as within the EU. Taking into consideration these additional steps, the amount of EU and Commission secondary legislation within the financial supervisory field makes the regulatory and surveillance procedures even more cumbersome for Norwegian legislators and the NSA.

From a Norwegian perspective, for EU secondary legislation to become part of our national legislation, the Constitution requires the approval of our Parliament.[42] This further means that all amendments initially also must pass by the Parliament.[43] Within the financial supervisory field, the Founding Regulations did not become a part of the EEA Agreement before 2016.[44] This created a huge backlog for Norwegian legislators who faced a huge task in updating the national legislation to become in line with the rules of the ESFS.[45] For the Norwegian NSA it was not easy taking on the role as daily supervisor within the financial markets of Europe and keeping an expedient dialogue with Norwegian financial institutions. I will briefly return to the challenges the financial institutions are faced with in the final subchapter of this article.

Norway does not have a soft law tradition and therefore not a streamlined procedure for how these types of acts are dealt with. This depends on the sector, and within the financial supervisory field Norway participates on an equal footing as the EU Member States in that the ESAs have competence to issue guidelines and recommendations directly towards "EEA competent authorities and market operators".[46] Guidelines and recommendations are directly published

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42 Article 26 (2) of the Norwegian Constitution.

43 Note that in Norway it is possible to make exemptions from Parliament approval in the initial law, which facilitates implementation of subsequent amending legislation. This has been done within the financial supervisory field to deal with the amount of legislation coming from the EU. For more about this, see Torje Sunde, Jon Lunde and Ida Sørebø, "EØS-lovgivningen. Fra EU-rett til EØS-rett til norsk rett" (Universitetsforlaget 2023), p. 245. In this sense, such a possibility to facilitate the implementation procedure is positive, but it should be used with carefulness and not the least in a consistent manner. In Norway there was a social security scandal in 2019, the largest one in Norwegian modern history. The causes of this scandal were many, but one of the reasons as to why the rules on the free movement of persons had been practiced wrong was the fact that there had not been a consistent approach to implementing amending legal acts. Some were passed by Parliament, others were not, creating a messy regulatory framework which had severe consequences for Norwegian citizens receiving unemployment – or sickness benefits or work assessment allowances. For more about this scandal, see inter alia the Norwegian prepatory work of NOU 2020:9 Blindsonen, summary in English pp. 26–29. Case E-8/20, Criminal Proceedings against N, Judgment of the EFTA Court of 5 May [2021]. Hans Petter Graver, "The Impossibility of Upholding the Rule of Law When You Don't Know the Rules of the Law: The Norwegian Social Insurance Scandal" (Verfassungsblog 2019) https://verfassungsblog.de/the-impossibility-of-upholding-the-rule-of-law-when-you-dont-know-the-rules-of-the-law/, DOI: 10.17176/20191114-205952-0 [last accessed 21/10-2024].

44 Decisions of the EEA Joint Committee No. 199,- 200,- 201/2016.

45 The backlog consisted of several hundred legal acts, see the Norwegian prepatory work of Meld. St. 14 (2017-2018).

46 Decisions of the EEA Joint Committee No. 199,- 200,- 201/2016, recital 3. Tarjei Bekkedal, "Third State Participation in EU Agencies: Exploring the EEA Precedent" [2019] 56 *Common Market Law Review*, pp. 381–416.

on the NSA's website as soon as the NSA have confirmed its compliance in line with Article 16 of the Founding Regulations.[47]

Due to the less cumbersome route of soft laws into Norwegian legislation as opposed to regulations and directives, there is a timeline issue which has a negative domino effect. Although the backlog explained earlier has been reduced dramatically in the last couple of years, it is (unfortunately) not uncommon that there is too large a time gap from EEA relevant financial legislation being adopted in the EU to it becoming part of the EEA Agreement. Note that the system is rigged in the way that there will always be some delays, but I refer to delays longer than that. This means that a situation may arise where guidelines or recommendations are issued without the relevant regulation or directive having been made part of the EEA Agreement. This delay has a negative domino effect on the relevant soft law because the Norwegian NSA (naturally) awaits its reporting of compliance until the EEA relevant directive or regulation has been made part of the EEA Agreement. This is obviously not ideal for national legislators and the NSA, but the largest frustration is for the Norwegian financial institutions operating in the European financial markets. This brings me to the last subchapter of this article.

### *3.4 Final Reflections: The Threat Towards Legal Certainty and Predictability for Financial Institutions*

The article has so far largely focused on the perspective of public authorities, both on EU and national levels. In the end what matters, however, is that the regulatory – and surveillance system contributes to legal certainty, predictability and transparency for those operating within the financial markets.[48] They are the ones that on a daily basis do business with the main aim of maximizing their profits. In order for them to be incentivized to provide their financial services within these markets, it is crucial with a regulatory – and surveillance system that safeguards the proper functioning of the markets and a level playing field for those wanting to operate there.[49]

I believe my analyses have demonstrated that both for financial institutions having their home state in an EU Member State, but perhaps even more so for financial institutions with their home state in an EEA/EFTA State, the regulatory landscape has become too intricate and difficult to navigate, which undermines legal certainty, predictability and transparency. Still, the system to a large degree works and the operators adapt. A worrisome trend in the Norwegian market is that operators are not too much concerned about what our national legislators and NSAs do. They are completely oriented towards what is going on at the EU level and are often ahead of their own national enforcers, which is understandable the way the system has developed.

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[47] See website here https://www.finanstilsynet.no/tema/finanstilsyn-og-regelverk-i-eos/regelverksarbeid-i-eos/ [last accessed 21/10-2024].

[48] I am not thinking of the customers of financial services, which I will not elaborate on this article, although their protection is crucial within functioning markets.

[49] By functioning markets, I am mainly referring to the aims of preserving financial stability, promote confidence and provide protection for consumers.

Further, I do not believe the market operators are concerned with whether the obligations stem from an EU directive, a guideline or a Commission regulation. When an NSA has declared its compliance with a guideline, or when a Commission regulation contains obligations that should have passed the Parliament and the Council, this is rarely challenged. Note that a guideline would not even be challengeable in front of national courts – one would have to challenge the legal act it is connected to.

Bobek was right when stating that the entire system is designed to function in precisely that way. As mentioned earlier this is the "name of the game": Access to the financial markets of Europe requires that those operating there follow the rules. But it does not change the obvious development of an increasing number of rules coming through the backdoor. With this article I therefore call for scrutiny of the regulatory practices within the financial supervisory field, and I encourage the EU institutions to choose the right legislative procedure if bindingness is intended.