

LAW AND ECONOMICS YEARLY REVIEW

ISSUES ON FINANCIAL
MARKET
REGULATION,
BUSINESS
DEVELOPMENT AND
GOVERNMENT'S
POLICIES ON
GLOBALIZATION

Editors

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Mission

The “Law and Economics Yearly Review” is an academic journal to promote a legal and economic debate. It is published twice annually (Part I and Part II), by the Fondazione Gerardo Capriglione Onlus (an organization aimed to promote and develop the research activity on financial regulation) in association with Queen Mary University of London. The journal faces questions about development issues and other several matters related to the international context, originated by globalization. Delays in political actions, limits of certain Government’s policies, business development constraints and the “sovereign debt crisis” are some aims of our studies. The global financial and economic crisis is analysed in its controversial perspectives; the same approach qualifies the research of possible remedies to override this period of progressive capitalism’s turbulences and to promote a sustainable retrieval.

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Guido Alpa

PRESENTATION

1. It is difficult to explain the reasons why there is a need for a new *Law Review*, focusing on the diffusion of information, analysis of themes and issues geared towards the evaluation of the role of «law» in a global economic system. What is certain is that, behind an initiative such as this there is the consciousness of the increasing relevance that various topics converging into law of economics currently have. There is the intention to theorise a new instrument aimed at supporting in the comprehension of complex events, and there is the commitment to stress the importance of regulation in order to limit reference to technique as disciplinary criterion.

Generally speaking, the justification of a new «*law and economics*» *Review* must be based upon a common belief that only the order resulting from «*fair rules*» may remove the unbalances and antinomies of a dysfunctional market trend, reduce the limitations to development caused by unfair behaviours and ensure government action coherent with the needs of the community. Identifying – through the indications deriving from research - possible new «operating instruments», as well as systemic aggregations (implemented at a particular or general level) functional to an «overall growth» of nations means achieving the necessary options for a «globalisation» which brings together rather than separates. This indeed is the goal to pursue by way of a cognitive approach oriented to the study of those factors which a reality in rapid expansion such as this one is based upon.

Hence the peculiar *mission* of a law review that aims at involving scholars from different countries, thus treasuring their *expertise* in order to achieve the aforementioned goals. In this regard, the new law review intends to fuel the debate among legal scholars by hosting contributions of significant importance, stimulate the discussion between opposite views with the aim of favouring the achievement of a shared position, and facilitate the integration between different cultures by reducing them to one. Obviously, we are aware of the difficulties hindering the achievement of such an ambitious goal, but legal studies need audacity in order to opening up new avenues!

2. As commonly known, Europe and the entire world are living in a time of great uncertainty, which is necessary to face in an attempt to analyse the complex intertwining of law, economics and finance. The merge between such latter subjects deeply influences our current days characterized by various difficulties, which in some countries are exacerbated by the inefficiencies of politics and cultural backwardness. As a result, the very pillars of modern democratic structure appear to be challenged. This, in turn, complicates the identification of interpretative instruments allowing process simplification and the definition of reference models.

Notwithstanding the perceived necessity to renew the forms of juridical hermeneutics, an increasing sense of refusal for the appealing notion of a pure conceptual ordering surfaces: as a result, there is a conceived *dogmatic* weakness and a rediscovery of a close link between law and history, as well as between the norm and fact. The specificity of economic and financial matter, in this context, operates as a catalyst: the inference to the concreteness of a specific case, which is typical of *law and economics* studies, impacts on the reading and comprehen-

sion of phenomena, allowing a realistic interpretation coherent to their particular configuration.

It is therefore possible to proceed – on this analysis - to the identification of several components of the relevant socio-economic context, researching solutions directly influencing the future development of single legal systems. Such path opens a new perspective in which the knowledge of the phenomena is related to the need of government thereof avoiding overmastering behaviours, pairing the severity of rules with the morality of conducts. Self-discipline, fairness and equity become the benchmarks of an ideal «functional paradigm» that entrusts the safeguard of the integrity and stability of systems, as well as the sense of responsibility of market operators, with the ultimate goal of achieving the highest standards of life.

These are the indications coming from the current historical and economic situation. This is the direction towards which the new *Law Review*, which we hereby introduce, intends to move. The research shows a path bristled with difficulties; however, there are no other options when one attempts to overcome adversities deriving from progress and the expansion of relations at global level. The coveted goal will consist in having contributed to spread the benefits deriving from social relations, which is the community of life among different people.

Francesco Capriglione

Editor-in-Chief

FINANCIAL CRISIS AND SOVEREIGN DEBT.

THE EUROPEAN UNION BETWEEN RISKS AND OPPORTUNITIES

Francesco Capriglione and Gabriele Semeraro*

ABSTRACT: *A key element for understanding the possible developments of the sovereign debt crisis relates to several rounds of non-standard interventions, ranging from the first Security Market Programme to the enhanced Long Term Refinancing Operations, launched by the European Central Bank from May 2010 to March 2012 as a reaction to the exceptional circumstances prevailing in financial markets. In the meantime, the other European institutions prepared and approved a number of legislative changes, intended to enhance the common economic governance and budgetary surveillance. This paper looks at the implications of the “non-standard measures” for the institutional role of the Central Bank in the context of the European Treaty, and examines the new legal acts as instruments to correct and prevent imbalances. The lessons from the Greek case point to more general elements of weakness in the Union, which can only be addressed by an integrated set of significant changes in the EU architecture. Specific attention should be paid to the role played by the rating agencies, and to the opportunity to foresee appropriate supervision by public authorities over them: taking into account that the current regulation seems far from satisfactory, and reforms in line with those enacted in the US would greatly help. The need for solid and sustainable fiscal policies remains key, together with appropriate budgetary and macroeconomic surveillance. The main characteristics to be designed for structured interventions are then described and discussed, with specific regard to the*

* Although this paper is a result of joint reflection, F. Capriglione wrote paragraphs 1-8, 10,15 and 18, whereas G. Semeraro wrote paragraphs 9, 11-14, 16 and 17.

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necessary surveillance of the degree of achievement of agreed policies and outcomes, aimed at addressing issues of moral hazard. The Six Pack and the Fiscal Compact Treaty may be seen as important steps in the right direction, but not as definitive solutions. In this context, non-standard interventions – including the ECB measures as well as use of EFSF/ESM fund – cannot go beyond a short-term solution, only temporarily addressing the malfunctioning of securities markets. Their ability to restore an appropriate monetary policy transmission mechanism is linked to successful implementation of other reforms herewith analysed. At a more general level, a change is required toward the observance of rules inspired by social responsibility, properly linked to merit and rigour. All this might result to the approval of new instruments of enhanced integration, not feasible in previous years; or lead, in the opposite case, to critical consequences for the continuity of the Union in its current form.

SUMMARY: 1. Introduction. - 2. From the ERM to the EU: a difficult transition, euro-sceptical doubts, the need for cohesion aimed at growth. - 3. The “financial turmoil” and the “sovereign debt crisis”. - 4. The euro area member states, between difficulties in recovering and the need for re-thinking the EU rules. - 5. (continued): The Greek case. - 6. The speculative attacks - 7. (continued): ... Influence of the rating agencies. - 8. (continued): The need for their supervision - 9. The need for appropriate rules on the statistics used for budgetary and macroeconomic surveillance. - 10. Redesigning the financial architecture and stabilization measures in the eurozone - 11. The Security Market Programme - 12. (continued): The ECB and recent extraordinary operations (LTROs). - 13. Other devices for stabilization: the EFSF/ESM and the eurobonds - 14. The Fiscal Compact Treaty - 15. A cultural change with respect to mutual assistance - 16. Opportunities arising from the crisis: a possible substantial reform for the EU governance - 17. (continued): Towards a “European economic constitution”? - 18. Concluding remarks.

1. The financial crisis, which started in the summer of 2007, was initially focused on financial assets issued by the private sector, extending its effects, since the second half of 2010, to the market for sovereign debt. This latter has

shown serious imbalances that have stressed the strength of the Eurosystem and, in particular, of some eurozone countries.

The need to review the type of interventions used to contain more expansive forms of the previous disparities, has highlighted the limits of a European Union founded on the assumption that the chosen levels of economic and legal convergence would also be adequate to support common development and growth, thanks to the presence of the single currency.

Therefore, operative difficulties of the delegation emerged in the Maastricht Treaty for the European Central Bank (ECB) to manage currency and exchange rates: in particular there has been the consideration of the provisions of article 123 of the EU Treaty (which prohibits the granting of credit facilities with banks in the Union, typically purchasing securities, by the ECB and national central banks), as well as of article 125 (which enshrines the so-called “no bailout”, or the prohibition preventing any member states from buying the debt of another EU country).

The tensions on sovereign debt have been exacerbated by the speculative attacks on markets, by the negative phenomenon of ‘capital outflow’ outside the Eurozone¹, and by fears on the possible emergence of «a negative spiral between low growth, deteriorating public finances and problems with banking systems»². In this scenario, marked out by the fall in German interest rates, growing doubts have been relating to the ability of the ECB’s non-standard measures (further enhanced since 2010) to effectively address market tensions.

These operations of the European Central Bank were aimed at improving liquidity conditions for the eurozone banking sector - making available adequate funds, in order to alleviate tensions in funding markets. On the one hand they have provided a prompt and valid response to increasing risks for a «credit-

¹ See inter alia BONINI, *Evasione, la grande fuga dei capitali 11 miliardi all'estero illegalmente*, in *La Repubblica*, 28 December 2011.

² See BANK OF ITALY, *Annual Report for 2011 - The Governor's Concluding Remarks*, 31 May 2012, p. 6.

crunch»; but on the other hand, they have been revealing their own insufficiency.

Indeed, they perform a function that is necessarily limited to the short term, since the assumption of enduring and resolving structural remedies would need an *agere* not circumscribed to the action of central Bank. It is clear that these interventions, expression of big commitment of the ECB leaders, will not stop the increasing difficulties arising from a crisis that, beyond its financial and economic feature, involves the foundations of EU itself, i.e. the member states' ability of 'holding together' without the glue of policy union.

The situation in Greece in the second half of 2011, the fast contagion deriving from other states with higher public debt (in primis Italy and Spain), giving way to a strong euro-sceptic tendency (increased by the widespread beliefs of possible default of some EU countries), raise doubts about the mechanisms of action that have been enacted by the ECB. These latter, as just noted, though formally consistent with the relevant regulatory framework, are often criticized as possibly conflicting with the pillars of the construction carried out by the Maastricht Treaty.

Indeed, the volatility of markets and the widespread uncertainty that characterizes the reality in question, leave few chances for a way out from the impasse in which many countries are confronted; there are several questions about what might be the correct solution to prevent the financial crisis, and with it the sovereign debt, in order to avoid the euro break-up³.

At the heart of this problem lies the awareness that the policy held by the ECB – although aimed at restoring the regular mechanism of transmission of monetary policy and, therefore, at a stabilizing the sovereign debt market – cannot be regarded as definitive, in absence of adequate institutional changes in the central bank statute.

³ See ALESINA and GIAVAZZI, *C'è una sola via d'uscita*, edited by *Corriere della sera*, 24 November 2011.

In literature, it has been underlined that the specific role actually played by the ECB does not seem immediately related to its own rules of action⁴. It follows the urgency to redefine its functions, in line with the powers available to other central banks. This reflection closely relates to the limits, clearly emerged, of the idea (assumed in the Maastricht Treaty) of limiting the scope of the common economic policy to monetary aspects: in fact, it seems now that there are no elements to achieve, through the monetary union alone, sufficient cohesion between the governments of member States, able to ensure the stability of the system.

From another perspective, the analysis – taking also into account the trade and capital flows in the eurozone – should consider all possible destabilizing effect for the entire Union from the exit of its members; this should apply even in the case where the exiting country is a strong economy (because of credits and other interrelations with other states).

Hence there is a need to find a model of governance that allows to reconcile the interventions in support of indicated purposes (addressing speculative attacks on the sovereign debt markets, while pursuing, at the same time, solid fiscal policies) with the perspective of broadening the original scopes stated in the Union treaties, extending the importance of all relevant policies. Considered as a whole, the Eurozone «has external accounts in balance; an estimated public sector deficit and debt for the current year of just over 3 and 90 per cent of GDP, respectively (...). The numbers depict a solid and balanced economy, in many respects more so than other advanced areas of the world»⁵. Those indicators refer to an economy that, unitarily evaluated (and living aside national selfishness and lax behaviours, as will be underlined in this contribution) has in

⁴ See GROS, *Conflicts of interest in central banking*, in *Central Banking Journal*, 22 August 2011; REICHLIN L., *Il duello (e l'equivoco) tra la Cancelliera e Trichet*, in *Corriere della Sera*, 20 July 2011; ID., *Tassi e ruolo della BCE*, in *Corriere della Sera*, 18 August 2011.

⁵ See BANK OF ITALY (2011) page 14, in which it has been also pointed out that households have «gross financial wealth three times their annual disposable income and debt equal to that income; and aggregate corporate financial debt [is] equal to one year's output ».

itself all elements for a full recovery, able not just to survive the financial crisis and related market tensions, but also to ensure in the future levels of growth in line with the tradition and importance unanimously recognized to Europe.

2. In order to analyze exhaustively the question indicated above, it is important in this investigation to start with a review of the economic process behind the transition from “European Monetary System” to “European Union”.

According to the common scholarly debate, the definition of the community structure of monetary function, realized in 1979 with the European Monetary System (EMS), marks a sort of compromise between “the opportunity to achieve an upgrade to the single currency” and “the risk to degenerate into an area of free trade as well as European Free Trade Association model”⁶; in this regard, doubts have risen about the effectiveness of the adopted instrument.⁷ Preordained to the aim of making the integration of the markets easier – and, therefore, the achievement of institutional purposes of the Community (free movement of people, services and capital), that over decades from Treaty of Rome (1957) have not been completely implemented – the EMS did not delay in revealing its limits, showing it was unable to keep the role assigned, being solely of aid in a potential transition for the purpose of monetary integration⁸.

In the mid-1980s, the European structure underlined the persistent relevant limits that resulted in an obstacle to its growth and the achievement fulfilling the aims of the founding fathers of the Community. To reduce the costs of transactions, eliminate the financial barriers that restrain the free trade, exceed the delays involved in the normative regulations, identify the elements of a

⁶ See MASINI, *Premessa to AA.VV., SMemorie della lira. Gli economisti italiani e l'adesione al Sistema Monetario Europeo*, Milan, 2004, 9; for an overview of the scholarly debate on SME see LUDLOW, *The Marking of the European Monetary System*, London, 1982.

⁷ See inter alia MASERA, *L'unificazione monetaria e lo SME*, Bologna, 1980; ID., *L'evoluzione del sistema monetario europeo (aspetti tecno-economici)*, in AA.VV., *Dal sistema monetario europeo al sistema europeo delle banche centrali*, Rome, 1990, 31.

⁸ See PADOA SCHIOPPA, *Lo SME non basta più: ci vuole l'Unione monetaria*, in AA.VV., *L'Europa verso l'unione monetaria*, Torino, 1987; ID., *Europa, forza gentile*, Bologna, 2001.

reality that seems still far from being achieved, represent the objectives culminating in the so-called Delors Report. In fact, in the consideration of one of the main protagonists of Europe the keystones of the known “inconsistent quartet”⁹ are identified in the complex conciliation between “free trade, capital mobility, independent domestic monetary policies and fixed exchange rates”; in this regard, it is possible to identify the way forward, recognizing the final intention in the realization of a real monetary union, for which a further obstacle is represented by the monetary sovereignty that, all along, has constituted an indefeasible prerogative of the states¹⁰.

The predisposition of Single European Act (which came into force in 1987) introduces some significant changes to the community organization and puts the basis for definitive removal of barriers that, on legal ground, interfere with the freedom of establishment and freedom to provide services in the financial framework¹¹. In a short time (in 1989) the Delors Report, mentioned earlier, outlined the steps designed to make fulfilment of the economic and monetary union as follows: (i) abolition of restrictions to free movement of capital in the area and strengthening of links between the currencies through implementation by member states to EMS, (ii) institution of the European federal bank, (iii) transition to the system of fixed exchanges and assignment of competences on monetary ground to the community bodies¹².

The story regarding the creation of the European monetary union is noteworthy, completed (in line with the recommendations of Delors Report), prior

⁹ See PADOA SCHIOPPA, *The European Monetary System. A Long Term View*, in AA.VV., *The European Monetary System*, Cambridge University Press, Cambridge, 1988.

¹⁰ For an illustration of the discussion see SAVONA, *La sovranità monetaria*, Rome, 1974, in which a deep analysis of the historical reasons and practical underneath to the concept of currency is provided, as well as the clarification of monetary sovereignty term: “the capacity held by monetary authorities to fix the interest rate” (42).

¹¹ See PADOA SCHIOPPA, *Verso un ordinamento bancario europeo*, in *Bollettino economico* of the Bank of Italy, No. 10, 1988, 57.

¹² See for an evaluation of the different aspects of this transition to European Union MASERA, *L'evoluzione del sistema monetario europeo (aspetti tecno-economici)*, *supra*, 38, in which the problem of necessary harmonization of the financial and fiscal regulations is underlined. See also CIOCCA, *Banca finanza mercato*, Turin, 1991, 171.

to the modification of the Treaty establishing the European Economic Community and the stipulation of new agreements that were terminated with the Treaty signed in Maastricht on 7 February 1992.¹³ The preparatory acts for the issuing of a single currency – that are involved in the realization of the Economic and Monetary Union (UEM), followed by the creation of the European Monetary Institute (IME) and European System of Central Banks (SEBC) – saw the governments of eleven participants countries committed, until the end of 1998, in a difficult task of “economic convergence” in a coordination of the national monetary policies. The aim of these joint efforts was to achieve an adequate level of cohesion – evaluated with regard to four parameters: price stability, exchange stability, the levels of interest rates, the sustainability of public finance condition. The objectives were, then, positively judged by the European Council, as qualified to decide “if the majority of member States fulfils with necessary conditions for the adoption of single currency” (Art. 121, paragraph 2 of the Treaty).

The logic of co-operation in which the construction of the Union is founded is innovative: to promote the sustainable economic and social development allowing the realization of a “single institutional framework”, that ensures the coherence and continuity of action (observing member states and providing them with the necessary tools to bring completion of the policies pursued). The integration model, foreseeing the realization of common policies, goes beyond the perspective of previous hypotheses of economic unification. In this regard, the decisive role now recognized for the functioning of community institutions is meaningful: thereto, it provides confirmation of the definition of specific com-

¹³ See inter alia AA.VV., *Dalla Comunità all'Unione Europea*, Attina and Velo (eds), Bari, 1994; KENEN, *Fiscal Policy and EMU*, in AA.VV., *Economic and monetary union in Europe. Moving beyond Maastricht*, Cambridge, Massachusetts, 1995; see *Memoria sull'attuazione del Trattato di Maastricht da parte delle banche centrali*, in *Documents of the Bank of Italy*, 1997, No. 563; see also ROSELLI, *Governo valutario, liberalizzazione ed Unione monetaria europea. Profili istituzionali*, Turin, 1998.

petences and decision procedures of European bodies (in which sovereignty fields are transferred) for the achievement of the purposes of Treaty.

In this context, the Statute of the ESCB and of the ECB plays an important role in the preparation scheme that seems destined to insert a mechanism oriented to maximize the advantages of the common market. It is important to note that the traceability to a single monetary sign operates as a catalyst in the removal of conversion costs and as a screen of exchange risks (in addition to making prices transparent), which facilitates the movement of capital, goods and people, with consequent improvement of competition. In the same way, the strengthening of international trades linked to the huge area of the euro-zone and the use of this as currency reserve on financial markets are significant. The positive evaluations formulated with regard to the realization of policies and common actions are therefore understandable, made feasible by the definition of common objectives pursued according to the principles of a clean economic market and supported by the proposition of no inflationary growth, in which the activity of ECB is preordained¹⁴.

To the single currency are linked the expectations that, on one hand, do not find an adequate place in some intrinsic limits behind the modality of the realization of the euro, and on the other hand go beyond the “spirit” that some countries have granted their adhesion to the Union. From here some euro-criticisms that, against some first doubts justified by the level of interdependence of community States, have continued over time, exacerbated in recent years following the rise of the serious financial crisis already mentioned.

A first consideration regards the framework in which the euro system operates: price stability, fair public finance and sustainable balance of payments. In this respect, it is relevant that the missed traceability to the ratio “public debt - GDP”, that certainly would have ensured the curb, avoided in some states, of forms of large spending . Above all, we have to consider the doubts determined

¹⁴ See inter alia GOODHART, *The Central Bank and the Financial System*, Basingstoke, 1995; see also SMITS, *The European Central Bank. Institutional Aspects*, Nederhost den Berg, 1997.

by the structural differences existing between participant countries and, therefore, the different levels of development between the same countries. As regards the evident uneasiness wherein many of them are founded - constrained in an “obligated relationship” with others of different and more significant economic relevance – the confirmation of this are the consequences of short-term official rates variations (the only one for the entire area) intended to draw on a different reality (and, therefore, with presumably differing effects). From here the question about the solidity of national fiscal policies – that may be different (even though arranged) – destined to absorb the asymmetric shock that hit in particular one or more countries of the Union, so the need to design adequate levels of flexibility to the manoeuvres just indicated.

In addition, the question of the real manoeuvrability, to enable the cyclic stabilization of national public balance sheets (an instrument of political economy left by the Treaty in the hand of single member states) is significant. Notwithstanding, therefore, there have great difficulties in relation to the constraints imposed by the so-called Stability and Growth Pact (SGP) (introduced with the Treaty of Amsterdam Protocol on June 1997) that intends to guarantee a strict application of the rules adopted in Maastricht (obligating each country to obtain in the medium-term an annual budget deficit no higher than 3% of GDP).

In this regard, therefore, a reality has been set up in which precarious balances are identified, linked to different reasons and made more evident by the flexibility criteria introduced to expand the institutional framework of co-operation, that also wants the possible involvement of the “States that do not want or may not adhere” under specific conditions¹⁵. In addition, allowing access to the Union after a certain period, provoked a dangerous mechanism in the matter of “controls” implementation on entry and, therefore, the verifica-

¹⁵ See SECCHI and VELO, *Introduzione* in AA.VV., *La conferenza intergovernativa europea del 1996*, Bari, 1997, 9.

tion of necessary guarantees to ensure the feasibility of the objectives of the Treaty.

On the other side, as anticipated earlier, there is a factor of criticality in the perspectives of the success of the single currency in the approach to adhesion to the single currency. Of significance, in this regard, is the position of Germany –which is notoriously recognized as a great weight (with respect to other countries) in the community ground – that has all along identified the objective of Treaty of Maastricht as the achievement of “a Union ever more close of the European nations – organized in States - and not instead ... (in the realization of) ... a State founded on a European nation”¹⁶; This belief has formed part of the German constitutional jurisprudence up to now.¹⁷ Consequently, there is an intrinsic limit of this indicated architecture: remitting the causal foundation of the Union to the relation of merely membership nature between member countries, inevitably hit the cohesion of relative institutional framework, underlining the difficulties of maintaining the existence of the single currency in the absence of a previous underlying political unity.

3. The law and economics literature have extensively analyzed the causes behind the financial crisis that has hit a large part of the world since 2007, de-

¹⁶ In these terms, see the ruling of Federal German Constitutional Court (12 October 1993), in which the limits of compatibility of the European Union with the Fundamental Chart and with basic principles of national legal system was fixed; see the contribution in Giur. cost., 1994, 677 and, for a critical appraisal see RESCIGNO G.U., *Il tribunale costituzionale federale tedesco e i nodi costituzionali del processo di unificazione europea*, ivi, 3115; EVERLING, *Zur Stellung der Mitgliedstaaten der Europäischen Union als “Herren der Verträge”*, in BEYRLING, BOTHE, HOFMANN and PETERSMANN, *Rechts zwischen Umbruch und Bewahrung-Volkr-recht-Europarecht-Staatrecht. Festschrift für R. Bernhardt*, Berlin, 1995, 1161; HERDEGEN, *Germany’s Constitutional Court and Parliament: Factors of Uncertainty for the Monetary Union?*, in *European Monetary Union*, Wtch, XIX, 1996, 8.

¹⁷ See the ruling of German Constitutional Court (30 June 2009) on the compatibility of ratification of Lisbon Treaty with Grundgesetz; see also the comments of DICKMANN, *Integrazione europea e democrazia parlamentare secondo il tribunale costituzionale federale tedesco* and CASSETTI, *Il “Sì, ma” del Tribunale costituzionale federale tedesco sulla ratifica del Trattato di Lisbona tra passato e futuro dell’integrazione europea*, both available from www.federalismi.it.

termining a serious recessionary process is still in place¹⁸. It is noteworthy that the mentioned events must be traced back to an inappropriate use of mechanisms of securitization linked with the so-called subprime loans and, generally, to the boom of the derivatives phenomenon (with its inevitable degenerations), as a result of the negative effects of a policy oriented to unstoppable growth, whose criticality, however, dates back in time¹⁹; financial systems dominated by banks and the existent process of globalization, through a perverse dominoes effect, have caused the rapid diffusion of crisis in large part of the world.

In a similar way, the deficiency shown by public supervision action in banking and financial sector is noteworthy: unsuitable forms of connection (between different states) emerged in the exercise of supervision and there is the difficulty of capitalism that is not able to pass over some intrinsic limits (confirming the need of an international discipline of economics)²⁰. On the contrary, in contrast to what happened during the big crisis of 1929 – in which the central banks were reluctant to proceed to an adequate expansion of monetary mass (because they did not understand the causes and the real nature of the crisis)²¹ – it has now been discovered that there is a strong responsive capacity by the monetary authorities in the evaluation of financial phenomena and elaboration

¹⁸ See inter alia BERNANKE, *Speech at the Council on Foreign Relations, Washington, D.C.*, 10 March 2009; TRICHET, *The ECB's response to the crisis*, Paris, 20 February 2009, available on www.ecb.int; MASERA, *The Great Financial Crisis. Economics, Regulation and Risk*, 2009, Rome; CAPRIGLIONE, *Crisi a confronto (1929 e 2009). Il caso italiano*, Padua, 2009; COLOMBINI, *La crisi finanziaria e la riforma Obama*, in *Riv. trim. dir. ec.*, 2010, No. 1, 201; ENRIA, *Lo stato del sistema bancario italiano e le prospettive per l'attività normativa*, audition held at Chamber of Deputies [Finance Commission] on 17 November 2010, available on www.bancaditalia.it/interventi/altri/ 2010; AA.VV., *The Dodd-Frank Act and the New Architecture of Global Finance*, New York, 2011; COLOMBINI and CALABRÒ, *Crisi finanziarie. Banche e Stati*, Turin, 2011.

¹⁹ See VISCO, *La crisi finanziaria e le previsioni degli economisti*, Lecture held at Master in Public Economics, University of Rome 'La Sapienza', 4 March 2009, in which it was accurately reminded that "the problems emerged in 2007 in the finance structured markets linked with *subprime loans* have caused the crisis, but the conditions of its rapidly appearance and spread were gradually accumulated over the years", contribution available on www.bancaditalia.it.

²⁰ See RAJAN-ZINGALES, *Salvare il capitalismo dai capitalisti*, Turin, 2008, *passim*.

²¹ See for the Italian case CIOCCA and TONIOLO, *Industry and finance in Italy, 1918-1940*, in *The Journal of Economic History*, 1983.

of a common position regarding the predisposition of mechanisms oriented to operate on a worldwide scale.

In this context, the link between crisis events and lack of “confidence” of investors on markets, the primary cause of the weakness of financial systems is significant. In fact, it is a common opinion that the origin of imbalances that have occurred on markets must also be analyzed in the large number of factors that introduce elements of uncertainty in the financial agere, modifying the process of events (in respect of defection of the operative used mechanisms)²². This uncertainty is at the base of a negative spiral that has fuelled the lack of confidence of consumers, determining a self-enforcing effect in the context of the financial turmoil: it has concerned in particular the quantitative data that distinguish the importance of and qualify the dimension of crisis; a confirmation of that is the request made to intermediaries by some financial authorities to “eliminate all toxic securities from their balance sheet”²³.

In respect of the explained pathological situation, the individuation of possible necessary remedies for turning financial systems back into a prospect of desirable return to stability occur in modality aimed to obviate the lack of liquidity, in a way to sustain the real economy stimulating the demand of goods²⁴. From rescue plans approved by US Congress²⁵ to the adopted measures of support in favour of banks in Europe²⁶, a common effort preor-

²² See inter alia SOROS, *The new Paradigm for Financial Markets: The credit Crisis of 2008 and What it Means*, Public Affairs, New York, 2008; see also TREMONTI, *La paura e la speranza. Europa: la crisi globale che si avvicina e la via per superarla*, Milan, 2008, *passim*.

²³ See DRAGHI, *Speech at G7 of Rome on 13-15 February 2009*, as quoted in the newspaper editorial “Draghi, monito alle banche “Tirate fuori i titoli tossici””, published on *Repubblica.it*.

²⁴ Specific intervention measures have been provided in the so-called *Recovery plan* released by the US President; see also *Obama’s speech to Congress*, 25 February 2009 available on www.bbc.co.uk.

²⁵ See *American Recovery and Reinvestment Act of 2009*, approved on 13 February 2009 by the US Senate containing *inter alia* provisions in matter of preservation and creation of job places, infrastructural investments, renewable energy sources, unemployed assistance.

²⁶ For an evaluation of the rescue plans adopted by several European countries (and, *inter alia*, by Sweden, Denmark, Portugal, Greece and Holland), see the website www.lavoce.info and, in particular, the review provided by Russo, *Paese per paese come si salvano le banche*, 17 November 2008.

dained to avoid that the crisis degenerate further on a situation woefully tested in the past is traceable²⁷. The modality with whom the public powers intervene in various countries seems to differentiate, even if it focuses on the common objective to prevent the intermediaries from being swept up by market failures. This action of rescue, enacted in some countries in the form of nationalization²⁸, is counterbalanced in other countries by the predisposition of public funds destined to purchase toxic securities, banks and financial companies²⁹, as well as the adoption of emergency measures that draw on the disciplinary work³⁰ and introduce projects of reforming the special regulations.

It is important to observe, however, that the indicated measures did not receive an equal response in the various countries. For instance, in Italy the decisions adopted by the Government – that means the enactment of Law Decree 9 October 2008, No. 155, containing “urgent measures to guarantee the stability of banking system and the continuity on supply of credit to firms and consumers”, converted into Law 4 December 2008, No. 190, and integrated by other normative provisions among which is relevant the Law No. 2 of 2009, regarding others modality of economic financing to realize through “public fund-raising of special bank obligations” (Art. 12) – have provoked distrust of the intermediaries, with the result that (except in some cases) they did not join the initiatives indicated.

²⁷ See *Statement of G7 Financial Ministers and Central bank governors*, 13–15 February 2009, available on www.g7finance.tesoro.it.

²⁸ This is the case, for instance, of Northern Rock Bank, which was nationalized in Great Britain with the *Banking (Special Provisions) Act* of 2008.

²⁹ See in particular the US emergency legislation that has provided the possibility for Treasury to purchase directly the shares of banks and financial institutions (*Treasury Announces TARP Capital Purchase Program Description*, October 2008); see also the parliamentary audition of the chair of Federal Reserve System Board of Governors (Bernanke), *Troubled Asset Relief Program and the Federal Reserves liquidity facilities*, Committee on Financial Services, US House of Representatives, November 2008.

³⁰ In this context, it is significant the possibility allowed to minority shareholders to join the board of directors, in order to favour the acquisition of shares in the capital of insolvency banks; see on this point FEDERAL RESERVE BOARD, *Policy statement on equity investments in bank holding companies*, September 2008.

The important task, with regard to the European regional framework, is the need to define mechanisms of policy capable to avoid, in future, the recurrence of crisis situations; giving rise to the need for research on the rational point of balance between the tendency to strict regulation and the need to avoid the operators (rectius: abuses) coming from controls that may hit the independence and, therefore, damage the logic of market. In this direction, as explained later (cf. *infra* paragraph 10), is oriented the reform of the architecture of the European financial system.

An event closely related to the financial crisis exploded in 2007 is the sovereign debt crisis perceived in some European states, particularly since 2010. In literature, this phenomenon has usually been explained as a consequence of interventions carried out by some countries to safeguard their financial systems in the presence of “subprime mortgage financial crisis”, which means a negative implication of the worsening of public accounts caused by commitments assumed to contrast and manage the financial crisis³¹.

In this regard, the first important cause that refers to the “sovereign debt crisis” must be identified in the recessionary boost emerging by financial turmoil, already mentioned. Consequently, there is an expectation of the inability of the states to reduce their own debt and, therefore, the quantitative data that negatively characterize the public accounts of some countries are critically evaluated, data that sometimes do not show differential lines in respect to the previous ones (that did not generate alarms on markets, in which the new economic reality swiftly causes concern and is watched as a factor of insecurity and instability of systems).

This explains, therefore, the reason that some states have recently become prey to significant speculation, favoured by various factors (including, in some cases, the increase of public debt linked with the need to face the finan-

³¹ See inter alia COLOMBINI and CALABRÒ, *Crisi finanziarie. Banche e Stati*, *supra*, 69; see also EGIDI, *Report* held at Luiss G. Carli University, in occasion of the academic year 2011/2012 opening day, Rome, 7 March 2012.

cial crisis). Postponing in the later treatment the examination of some aspects of this speculative process (that, often favoured by inappropriate interventions of the credit rating agencies, has subjected – and subjects – the states to the new form of attack), at this stage the peculiarity of the aim of the research must indicate . This situation is characterized by the increasing weakness of the banking sector (recently inflated by the stress test imposed by the European Banking Authority from where the need of recapitalizations was induced by downgrading of the securities of public debts held in portfolio) and for more accentuated self-centring of the markets (that downsize their institutional function of “centre of exchanges of financial instruments”, preordained to the productivity growth).

It is possible to delineate a context in which there is a “failure of theoretical models” that do not find a confirmation on concrete ground. In fact, it is relevant that there is an increasing financialization of the real economy in which, with no links to the economic fundamentals, the interventions on the market operate in a logic of the very short-term (destined to benefit from the up and down variation of securities cycles) and the research of new operative spaces is resolved on erosion of justified prerogatives, giving way to the gloomy phenomenon of competition for the market and not in the market³².

4. With reference to the assessment of the current conditions of eurozone countries most of the scholars complained about the non fulfilment of the “single currency promise”, a promise broken by inadequate economic convergence and by a political will not keen on actually implementing the program underlying the EMU³³.

In particular, it is highlighted that, according to quantitative data, in most of the member states (Germany excluded) deterioration in the GDP growth rate has been registered since 2000, clearly worsening with respect to the previous

³² See CAPRIGLIONE, *Ordine giuridico e processo economico nell'analisi di law and economics*, in Pellegrini (ed), *Elementi di diritto pubblico dell'economia*, Padua, 2012, p. 25.

³³ See DI TARANTO, *Le basi problematiche della moneta europea*, in *Aspenia, I futuri del capitalismo*, 2012, n. 56, pp.176-183.

decades. It has been hence pointed out that – in line with euroscepticism leanings fostered by financial speculation – a possible solution to the mentioned problem could be the “end of the euro” or the exit from the Eurosystem of member states with unresolved public debt problems.

This frame of mind inevitably removes all meaning from the idea of the possible implementation of a “political union”, an idea in which the founding fathers of the Union believed in³⁴.

Nowadays countries of the eurozone are undoubtedly facing several difficulties, some of which are caused by the persistent wide gap between each other, a gap so far not narrowed due to political delays (particularly significant in some member states) or due to their intrinsic high degree of differentiation, the latter being, in some cases, an element actually existing since the establishment of the Union (and that should have hence suggested a stricter approach).

It is clear that we are dealing with different abilities to face the current crisis, clearly not allowing the use of standard, common or shared intervention instruments against financial turbulences, indeed due to the previously mentioned high degree of differentiation such turbulences have different impacts on the “European” countries.

One thing that is certain is that the crisis has shown the limited effectiveness of the technical mechanism used to create the “single currency”. It has shown the lack of commitment by eurozone countries in adopting the normative instruments, progressively allowing the implementation of the political project underlying the establishment of the Monetary Union.

This is true in particular if we look at the failure to adopt the European Constitution in 2004, harshly contested through the dissenting vote of France

³⁴ Reference is made, in particular, to certain statements made by influential politicians in the occasion of the fixing of the exchange ratio between national currency and the euro, and so of the historical date of the launch of the single currency, see with reference to Italy the statements of Prime Minister CIAMPI published with the title *Italia, traguardi e sfide*, in *Il Sole 24 Ore*; January, 2 1999.

and Netherlands, or at the final content of the Lisbon Treaty where the original framework had been watered down, as pinpointed by Carlo Ciampi³⁵.

Disillusion and euro-scepticism are fostered by the memories of what happened on occasions of similar “stories” of European projects and of failures in establishing effective formulae to build a group, to create a link, among different monetary systems or to (embryonically) integrate them.

In particular, the events that happened more than a century ago spring to memory, when Belgium, France, Italy and Switzerland established the “Latin Monetary Union” (pursuant to the Paris Convention of 23 December 1865)³⁶.

At any rate, the spectre of the EU failure suggested by negative historical examples³⁷ is not persuasive and shall be removed as contradictory with reference to the actual advanced stage of development of the European economic and monetary integration process and the different (greater) maturity that nowadays qualifies the European citizenship.

Notwithstanding the undeniable shortcomings that currently affect the development of the Eurosystem – which are partially due to the inappropriate procedures so far followed for its establishment – the hypothesis of opting for the “end of the euro” shall mean considering a “remedy that is worse than the sickness”.

Indeed such a “remedy” – regardless of the (huge) cost for unwinding the institutional system established for the creation of the Monetary Union – shall produce, on one side, a negative impact on the existence of the European Community (with a step back in the degree of openness positively characterizing

³⁵ See: CIAMPI, *È un vero crollo: i giovani costruiscano un mondo nuovo*, interview with Trevisi and Colimberti, *Ariel, La rivista*, 2009, 1, p. 17.

³⁶ See: DE CECCO, *Moneta e impero. Il sistema finanziario internazionale dal 1890 al 1914*, Torino, 1979, p. 63 ss. For the text of Paris Convention see: MARCONCINI, *Le vicende dell'oro e dell'argento dalle premesse storiche alla liquidazione dell'Unione Monetaria Latina (1803/1925)*, Milan, 1929, p. 338 ss.

³⁷ In the XIX century examples of monetary unions occurred: among German-speaking countries the Treaty of Vienna of 1857 established the Prussian Monetary Union that lasted until 1867, and among Scandinavian countries. The Scandinavian monetary union lasted for almost 50 years, from 1873 to 1931; for further details see: MASTRANGELO, *Tentativi di unione monetaria in Europa dall'antichità al secolo XIX*, in *Rivista di Storia Finanziaria*, 2001, n. 6, p. 70 ss.

the current free movement of goods, services and individuals) and, on the other side (i.e. at single state level), shall dangerously leave the weakest member states exposed to the adverse conditions of devastating monetary policies.

In this respect, in order to foster growth, resorting to certain policy instruments woefully used in the past (i.e. competitive devaluation, public debt restructuring, etc.) would be likely.

This also has the additional problem that, in such a scenario, member states so far not hit hard by the financial crisis and with a sound balance sheet – and apparently heading to stable economic recovery (e.g. Germany and Netherlands) – shall be negatively affected; actually, the latter in view of the likely losses arising from the deterioration of their credits vis-a-vis states with a large public debt, shall experience a suddenly decrease of their exports (with an obvious negative impact on the virtuous circle that has, so far, allowed them a significant level of economic expansion).

Conversely, accepting the thesis of the “no way back” from the euro may mark a turning point in the Europeanization of member states, in particular if this approach is implemented through the responsible development of policy measures aimed at remedying the current EU shortcomings referred to above.

In other words, keeping the eurozone, defending its soundness, and believing in the possibility of having new and more intense forms of cohesion among member states represents an answer to financial crisis to sovereign debt crisis that (overcoming the ancient logic revolving on nationalistic view of democratic systems) is able to pick the opportunities offered by the mentioned events.

Of course, the progress of a common program aimed at realizing optimal development conditions – i.e. that enable political forces to work for the advent of a “democracy...aiming at realizing social justice”, as recently stated by a distinguished scholar³⁸ – shall be achieved by reshaping the EU financial regulatory

³⁸ See FITOUSSI, *La nuova ecologia politica*, Milano, 2009, p. 11.

framework, as already partially achieved (see paragraph 10 below), and through the adoption of new EU budget and fiscal rules, as emerging by current draft agreements (see paragraph 6 below).

It goes without saying that this process may have a positive outcome only if a cultural renewal occurs among eurozone countries that – by implementing the responsibility of political parties, and so the willingness to rigorously bind to the building of the common good – shall be preparatory to achieve the maturity necessary to reach the desired ambitious objectives.

5. The examination of the complex difficulties and risks actually faced by the European Union has its epicentre in Greece. The problem of the increasing yield of Greece securities, the pathologic level of the public debt of such a state that induced influential bankers to conjecture on its actual default (i.e. Klaas Knot, president of the Dutch central bank) hit the headlines and the studies of people that analyze the events causing instability to the Eurosystem, calling into question its continuity³⁹.

The history of this country is characterized by a casual management of fiscal policies (free from the limits imposed by the stability pact and with concealment of the real economic and financial condition of the country) whose natural consequence has been a non-sustainable deficit⁴⁰.

The decay, marked by a sad series of negative assessment by rating agencies, has been reflected by the huge increase in price and traded volumes of credit default swaps with Greek public debt securities as underlying asset, and

³⁹ Lately a set of data about the recent Greek economic history has been surveyed by DI TARANTO, *Il salvataggio temporaneo di Atene? Vantaggioso solo per Berlino*, in *Milano Finanza*, 16 March 2012.

⁴⁰ Already at the beginning of 2010 the public debt raised reaching more than 120% of GDP. This event has been followed by an increase of debt position towards other countries and a downgrading by international rating agencies (with the obvious difficulties in raising the funds necessary to maintain the adequate level of liquidity in the system), see: *La Crisi Finanziaria della Grecia*, edited by Borsa Italiana S.p.A., 5 February 2010; see also See NELSON, BELKIN and MIX, *Greece's Debt Crisis: Overview, Policy Responses, and Implications*. CRS Report for Congress, 2010, 14.5.

by the beginning of large speculative operations that produced unavoidable negative impact also on the euro, that has been obviously weakened, so facing problems mentioned in previous pages, problems related to so far unsettled issues of general importance⁴¹.

The research of possible remedies ranges from minimalist measures (i.e. simple bilateral credit facilities) to more extensive interventions (i.e. the management of the emergency through complex use of the EFSF, in buy-back operations).

Well, if at economic and financial level importance is primarily attached to the interest of some EU member states (in particular Germany) to avoid the Greek default may produce significant losses in their financial system⁴², at a legal level obstacles of a different nature impair the ability to come to a proper solution. Indeed, art. 123 and 125 of the EU Treaty hinder the possibility of giving financial support; the first article prohibits the ECB and NCB from allowing credit facilities (typically purchasing securities), the latter provides for the so-called “no bailout”, i.e. the prohibition of an EU member state from buying debt securities of another State.

Moreover, of relevance to the solution of this problem is the circumstance that the EU Treaty does not regulate the case of the forced exit from the euro-zone of one of its member countries; as pointed out, it “does not exist a mechanism in the New Treaty which allow for the expulsion (forced exit) from the EU or from the EMU”⁴³ of one of their members. In fact, while the Treaty of Lisbon (art. 50) provides for the right of exit (voluntary, unilateral or negotiated) from the EU, this right is not provided for with reference to the EMU. Therefore,

⁴¹ See also considerations published in *Bollettino mensile BCE*, Frankfurt am Main, February 11 2010, p. 31.

⁴² It must be recalled that German banks hold huge amounts of Greek public debt and the same Bundesbank holds more than 100 billion of credit towards Greece, see: DI TARANTO, *Il salvataggio temporaneo di Atene? Vantaggioso solo per Berlino*.

⁴³ See MASERA, *La crisi dell'Eurozona e l'Italia*, relazione al Convegno “Può l'Italia uscire dall'euro?”, (Fondazione Roma, 11 novembre 2011).

we are in the presence of institutional shortcomings that certainly have been an obstacle to a prompt solution of the Greek problem.

Against this remark shall be assessed the interventions so far implemented to manage the Greek situation. Reference is made to the purchase by the ECB, in May 2010, of Greek securities deemed applicable to the Greek crisis (according to art. 122.2 of the Treaty on the functioning of EU), the use of EU funds (the so-called European Stability Mechanism ESM, on the contrary established to regulate the relationship among EU member state and third-party countries) and the establishment of the ESFS (benefiting from the contribution of EU member states in the same proportion they contribute to the ECB), so attempting to reactivate the market of Greek securities and, consequently, to preserve the stability of the Union.

In this context, it can be explained that the Council of Europe approval (17 December 2010) of a proposed amendment to the Lisbon Treaty that, pursuant to art. 136 (allowing member states to adopt a Stability Mechanism or to depart from articles 123 and 125 if necessary to maintain the stability of the Union), allows for the granting of funds subject to the condition that the recipient state is bound by certain recovery projects.

It is clear that the position of substantial dependence held by Greece due to its burdensome debt level toward foreign creditors allows amendments to rules governing the Eurosystem, that in practice, influence the country's institutional framework.

Indeed, there is no doubt that the mentioned situation puts at stake the independence of the power of the state, as defined by logical frameworks referring to Kelsen theory, in the sense that it deprives the essence of sovereignty of its meaning⁴⁴.

⁴⁴ See: KELSEN, *Il problema della sovranità e la teoria del diritto internazionale*, a cura di Carriño, Milano, 1989. To verify the elements characterizing the concept of sovereignty see: GIANNINI M.S., *Sovranità*, in *Enc. dir.*, vol. XLIII, Milano, 1990, p. 224 ss.

It is not the case that a protagonist in European affairs in assessing the impact of Greek crisis on the relationship between Greece and the Community highlighted that in practice the former “is no more the only sovereign in his own house”⁴⁵, so clearly pointing at the occurred deprivation of the Greek political and administrative apparatus due to the above mentioned restraints.

It must also be emphasized that the mentioned interventions, even if they may entail the abdication by the Greeks a degree of autonomy, anyhow mark the introduction in the EU of operating rules of solidarity mechanisms, also structured with the aim of scaling down the commitment of certain countries⁴⁶.

This is even more evident where reference is made to the recent restructuring of the Greek debt, which causes a kind of privatization of losses, whose burden has been poured out on European banking system.

In this context, in February 2012 the Eurogroup finalized a second bailout package for Greece, causing the world’s largest debt-restructuring deal ever seen, affecting 200 billions of euros in bonds. Countries in the euro area (through the EFSF) and the IMF will grant Greece more than €138 bn in new loans. Part of that deal was a “private sector involvement” (or PSI) agreement, whereby private holders were asked to accept the write-off of 53.5% of the face value of Greek sovereign bonds, the equivalent to an overall loss of around 75%. On 9 March 2012, the Greek Minister of Finance announced that an extremely high majority of bond holders (86% subject to Greek law, and 69% subject to foreign law) voluntarily agreed with the PSI.

However, this successful outcome was not enough: the bailout agreement was conditional on other elements, including the implementation of new severe measures for fiscal consolidation and structural reforms, with strict deadlines

⁴⁵ See PADOA SCHIOPPA, *La sovranità in movimento*, Corriere della Sera of 15 February 2010.

⁴⁶ Reference is made to purchase of Greek public debt securities by NCB (that can be assimilated to a credit facility), securities that shall be redeemed at their nominal value. This implies the possibility of a capital gain for the bank (i.e. the difference between the nominal value and the purchase price), a capital gain that contribute to the annual result of the bank that is (partially passed to the Treasury. The latter uses such funds to reduce the interests rate on credits allowed to Greece, this because direct financing by the state is prohibited (art. 123 of EU Treaty).

and subject to a periodic assessment by the European Union, the ECB and the IMF. Therefore, the apparent success of the private sector involvement, even though able to raise some enthusiastic reactions, may hide political and social risks implied by the need to implement the counterpart measures included in the agreement, in a context of tensions following five years of recession. Owing to its unprecedented size, the PSI is very likely to be recalled in future years as a turning point; but this turn's outcome – whether toward starting the euro's break-up, or toward its strengthening – is not yet clear.

Finally, it must be specified that in assessing how emblematic the Greek case is, the responsibility of certain EU member states to determine this situation shall not be overlooked, not only because they allow Greece to access the Eurosystem without a proper assessment of the possession of necessary requirements, but also for not having supported, recently, the previous project aimed at strengthening Eurostat's investigative powers with reference to public accounts (a project rejected in 2005 by members of the Ecofin Council, agreeing not to allow further transfer of sovereignty to the EU Commission)⁴⁷.

The idea that Greece represents the weakest link in a longer chain encompassing the countries of the Mediterranean area (such as Spain, Portugal and Italy)⁴⁸ must induce one to think about the necessity of timely regulatory intervention, as well as financial, that flesh out a “European project” based on a innovative culture of solidarity. Only in this way can the helpful sacrifices of some European states, mirrored by austerity measures adopted by Greece, represent a common “willingness to stay together” justified by the commitment and reliability of all EU participants.

⁴⁷ The legal instruments that must be used is the amendment of Council Regulation (EC) n. 479/2009 (25 May 2009) “On the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community”, with reference to articles dealing with investigative powers of the Commission.

⁴⁸ See the leading article of CARETTO, *Come scongiurare l'eurosclosi*, reperibile su www.archivistorico.corriere.it del 12 febbraio 2010, where it is pointed out that the economist Shiller feared the beginning for the UE of a “lost decade”.

6. The crisis, as previously identified in its various components, beyond the recession effects that followed from it, gives space to the rage of the “monster of speculation”.

The pathological events that have occurred in recent years – with the emergence of the limits of government oversight over financial activities⁴⁹ – have shown an “insufficient harmonization of prudential regulations”⁵⁰, which has resulted in uncertainties in the identification of shared solutions, uncertainties due also to a reduced capacity of analysis of macro-prudential risks. In addition, it is possible to add the fears arising from the difficulty of some sovereign states to be able to cope with public debt towards its citizens and the international community, a reality exacerbated by the economic recession determined by the crisis.

The problematic nature of an early adoption of the necessary remedies to overcome the critical issues highlighted above, is matched by a prominent attraction to high yields arising from the use of considerable cash flows in operations that use the randomness of markets underlying the described situation; so, the presence of substantial sovereign debts acts as a catalyst in the “speculative attacks” against states with significant debts. These states – not able to withstand autonomously the elements of varied forces that coagulate and form an alliance in view of easy gain – are forced to suffer the devastating effects of a financial agere that (regardless of the causes of the accumulation of their debt and other deficiencies that, in time, have characterized their loss of

⁴⁹ Among others – SARCINELLI, *Nuove regole e mercati finanziari*, in *Bancaria*, 2009, 1, p. 31 and following; SICLARI, *Crisi dei mercati finanziari, vigilanza, regolamentazione*, in *Rivista trimestrale di diritto pubblico*, 2009, p. 45 and following; see also, the specifications made by TRICHET, *Remarks on the future of European financial regulation and supervision, at the Committee of European Securities Regulators (CESR)*, Paris, 23 February 2009, where it is underlined that: “The system must strengthen itself and build up its own defences. I propose a strengthening of the financial system that focuses on three goals: long-term sustainability, improved resilience and a holistic perspective”.

⁵⁰ See BOCCUZZI, *Gli assetti proprietari delle banche. Regole e controlli*, Torino, 2010, p. 185 and following.

credibility) appears, however, contrary to the canons of the regular order of the market, placing itself significantly outside a logic that makes reference to ethics.

In this way the vision that, in the past, a large part of economic doctrine expressed with regard to speculative interventions in the financial markets, positively evaluated (taking into account Friedman's thinking in terms of stabilizing effects ascribable to the same), is overwhelmed. At present, in the current global context, the ability to move (with negligible cost), large amounts of capital, has devalued the paradigm of a "harmless speculation" and seems to give space only to the degenerative profiles of the phenomenon in question. In fact, that expression denotes a closer correlation with events that impact negatively on the performance of the economy; so it is regarded primarily as an activity that often affects the lives of financial markets and that can destabilize countries against which it rages; hence the emergence of doubts about the possibility of continuing to hold systemic supranational construction (as it has recently been recorded with reference to fears of default of some eurozone countries).

Of course, referring to the elements of a deplorable speculation, it is not possible not to omit, nor justify, the delays and shortcomings of politics that, in some countries, have resulted in insufficiency of the rules, assumption that in turn led to conduct that benefited from the weakness of others⁵¹. It shall not be denied, however, that the degenerative effects of an unhealthy application of the principle of profit maximization are an obstacle to the affirmation of correct financial entrepreneurship. This explains why the market, as previously pointed out, has become self-referential, giving up its traditional role as a "house of trades" aimed at production and development. It should be noted, consequently, that the other face of an advanced capitalism system assumes a fundamental role in the use of operational forms (of very short term) at the base of a "wicked game" that puts strain on the resistance of certain states and has no respect for

⁵¹ See ABRAVANEL-D'AGNESE, *Regole*, Milano, 2010, p. 12, where, with reference to capitalism "without rules" or "of Anglo-Saxon origin", the authors refer to the widespread and deep conviction that "with the crisis, the end" of that form of capitalism "has started".

“the protection of savings” (a principle that, in some jurisdictions, like the Italian, has constitutional significance).

Hence the growing need to provide adequate safeguards to curb the violence of speculation, in order to avoid the risk of a sad alternation between attempts to contain it and the imperious resurrect of its vis demolitoria. The need to prevent the rise of unacceptable behavioural practices that find a manifestation in an agere that over time discredits itself and has endangered the welfare of future generations is inescapable. In the background is visible the lack of a culture of solidarity, in which the dangers that the economy cannot dominate are linked; it is evident, consequently, that there is a situation of powerlessness that can be resolved only with the suspension of certain types of operational typologies or upon imposition of technical forms to introduce maximum transparency (so as to avoid over-estimation of the price of the reinsurance underlying the speculative activity), or of a high tax burden (as was recently suggested by some European politicians)⁵².

The research – in stressing that legal rules should ensure a process free from economic constraints – must propose new paths, organizational plans and tools in order to ensure operational forms actually directed to the economic activity that is protected from disturbances. Abandoning dogmatism, resizing the canons of anomic societies of communication, revisiting the expectations of the knowledge economy, breaking the magic circle marked by a financial market which, as mentioned, seems to be moving away from its original function of the driving growth: these are the most important aspects of a process that is imposed in a desirable change. It will become, thus, possible to overcome the current obstacles to the economic recovery, triggering a reorganization of the

⁵² In this regard the proposal of a tax in financial transactions, suggested by Nicolas Sarkozy should be noted. This tax was also discussed by the Governor of the French Central Bank, Christian Noyer, as it is mentioned by *Rinascita* (24 February 2011). It is important to clarify here that such remedy, to be effective, should be applied “from all countries in the world, even by the less cooperative ones. In other words, it must also be introduced in ‘tax havens’, especially in those under British and American protectorate, through which huge amounts of capital are moved, looking for investments or objectives against which speculate”.

rules (i.e. a framework of global legal standards), through convergence of agreements that make possible the democratization of markets, through the prevention of risks (which, in regards to the eurozone, as will be better specified later, corresponding to an adequate fiscal compact aimed at the coordination of fiscal policies).

7. Speculation – as a degenerative effect of an advanced capitalist system – is favoured by the rules concerning the ratings given by the agencies that do this in an institutional way; the intervention of the latter, recently, also had significant repercussions on speculation directed at the sovereign debt of some states.

The truth of this assumption is grounded by the influence that the judgments made by these agencies exert on the operation of financial markets. The performance of the latter is, in fact, often influenced by the information (concerning the issuers of the securities) provided by the rating agencies; with the result that the assessments in question – coming from subjects deemed particularly competent (and, therefore, able to develop estimates appreciable for their objective validity) – inevitably end up impacting stock prices. Hence the need to ensure, on one hand, how rating is executed and in which ways it can be framed in legal terms, and on the other hand the disciplinary forms that, at present, regulate its extent. This is in order to identify the appropriate regulatory requirements to avoid an uncontrolled dominance of rating agencies in orienting the trades in financial markets.

In this regard, the investigation needs to be commenced from the origins of the rating, which is summed up in a method used for the classification of companies and securities based on references such as allowing a quantitative assessment related to risk⁵³.

⁵³ Amongst others – CANTOR R.-PACKER F, *Multiple ratings and credit standards: differences of opinion in the credit in the credit rating industry*, Research paper, Federal Reserve Bank of New York, November 1995; CANNATA, *La componente quantitativa dei rating delle agenzie. Alcune*

Therefore, consideration is given to the work undertaken to render transparent the significant economic and financial data of companies, whose activities are committed to such agencies, some of which (as is the case of Moody's) have been operative since the early decades of the twentieth century⁵⁴. Certainly the provision of specific "indices", intended to supplement the information provided in financial statements (which are public) of the subject's rating, makes a significant contribution, providing clarity and transparency to the system, and increasing the opportunity for markets to take into account the risks posed to the issuer. Consequently, the assessments will be looked at in favour of investors (formulated by vote via letter) that are regularly advertised by the agencies, which in fact, serve the purpose of showing the actual state of indebtedness of the subjects under observation and, therefore, often forcing them to take corrective or adequate preventative measures to prevent downgrading.

The sale to investors of the assessments made by the agency characterizes the original phase of business related to the rating: the incomes of nominated companies were, in fact, represented solely from fees paid for the purchase of "judgments" necessary to direct tasks to be carried out. The intervention of the agencies helps find opportunities to develop the reputation of the business, qualifying it in the same way as being particularly capable in respect of the risk assessment and credit rating of the recipient.

Business has changed during the twentieth century when, following the bankruptcies of several large companies⁵⁵, the certifications in question were aimed at verifying the stability and sustainability of the issuer's credit rating, fo-

evidenze empiriche, Luiss Guido Carli, Roma, 2002; COLQUITT, *Credit Risk Management*, McGraw Hill, New York, 2004; GANGUIN B., BILARDELLO J., *Standard & Poor's fundamentals of Corporate Credit Analysis*, McGraw Hill, New York, 2005.

⁵⁴ CARTY, *Moody's rating migration and credit quality correlation 1920-1996*, in S. DAS, *Credit derivatives: trading & management of credit & default risk*, Wiley, New York, 1998.

⁵⁵ This refers in particular to the failure of Penn Central which had issued \$ 82 million of debt securities giving rise to the need for more stringent controls on the issuers, hence the exponential growth of the agencies and, with them, their revenues and personnel.

cusing mainly on the latter, seeking “to voluntarily obtain a rating upon payment”⁵⁶. This marks the transition to using the rating (by the supervisory authorities) for the purposes of supervision, which is matched by the introduction of specific disciplinary rules. More precisely, a favour for the recognition of the agencies activity with respect to regulations will be determined in consideration of the close relationship it has with the objectives of the financial banking sector. In line with this evolutionary trend of the ratings it depicts the “best interest for the public”, highlighted by the doctrine that does not share the spirit as it was deemed contrary to the private nature of those who formulate the judgments⁵⁷.

Starting from the well-known Rule 15c3-1 – enacted in the mid-seventies by the US Securities and Exchange Commission⁵⁸ – which was seen as a point of reference for rating agencies for the definition of regulatory capital of financial intermediaries, numerous provisions can be found in the legislation of various countries that are called the “judgments” in question, considered suitable for the determination of capital requirements and to identify barriers to the operation of such others. This has given rise to a kind of “regulatory abdication” on behalf of those bodies, as emphasized by the carefully drafted doctrine, considering this phenomenon, which highlights the “increased...difference between the actual usefulness and perceived usefulness of ratings by investors”⁵⁹.

In the course of time, note the cross-references to credit ratings prepared by the so-called “Basel II” accord with respect to capital requirements of banks and the European requirements regarding eligible assets held by authorized mu-

⁵⁶ See PARMEGGIANI, *I problemi regolatori del rating e la via europea alla loro soluzione*, in *Banca impresa società*, 2010, p. 461.

⁵⁷ See MASERA R., *Rating “rating agenzie”, paper given in seminar ‘seminario FEBAF sulle agenzie di rating’*, ABI, 13 April, 2012; ID., *Così la politica può battere la dittatura del rating*, in *La Repubblica (Affari & Finanza)*, 23 January, 2012.

⁵⁸ On this occasion, was officially recognized the usefulness of “Nationally Recognized Statistical Rating Organizations” – NRSRO – to establish a distinction between issuers with more or less “volatile” market. See PARTNOY, *The Paradox of Credit Ratings*, 2001, available at www.ssrn.com.

⁵⁹ See ENRIQUES, *Rating e regolamentazione*, p. 1.

tual funds (pursuant to which the money market instruments may be subject to investments only if the issuer has investment grade)⁶⁰. In this case certain provisions of the Community regulations on insurance companies in which it plans to use the rating for the calculation of technical provisions are added, already practised in some countries, from the ratings provided by the agency in question⁶¹.

A business model for rating agencies is configured, for its functional modalities, which inevitably poses a delicate legal issue; which concerns, on the one hand, the regularity of the action undertaken, and on the other, the reactions of other regulators and markets in the presence of a judgment which is not merely limited to the incorporation of “the information available, but is itself information”,⁶² which is reflected (sometimes heavily) by the economy and finance. It is unclear who invests, therefore those in question, especially during the recent crisis, have played a significant role, becoming at times (in situations of great uncertainty and difficulty) arbitrators to the reality of the market, being able to affect the destinies of countries (often the recipients of their judgments), as well as the companies in which they express their opinions.

On further analysis, on one hand, with aspects that are by and large of a positive nature that seem intended for market stability (revealed in this respect, in the plane of supervision) the need to align the performance of the rating logic behind the ruling ensuring regularity and the correctness of those working in banking and finance appears inevitable.

Specifically, the agencies should act in a manner that respects certain general principles of law, commonly recognized in any order, including: (i) the

⁶⁰ See CANNATA-FABI-LAVIOLA, *Rating and internal credit risk management: measuring the probability of default*, in *Banking*, 2002, no. 4; BOCCUZZI, *Risks and guarantees in financial management*, Bari, 2006, p. 134 and following. See, also, the rules contained in Directive 2007/16/EC.

⁶¹ See THE JOINT FORUM, *Stocktaking on the use of credit ratings*, June 2009, available at www.iosco.org.

⁶² See PRESTI, *Le agenzie di rating: dalla protezione alla regolamentazione*, in *Atti del convegno su “I nuovi equilibri mondiali: imprese, banche, risparmiatori”*, Milano, 2009.

right to exercise a certain activity and (ii) the assumption of responsibility for assessments made. The need to exclude any possibility of bringing them to particular purposes and therefore enabling them to find placement in settings that are in a conflict of interest is then taken into consideration.

From the above, it would be possible to shape an obligation of the agency, characterized by the specificity of its technical content, of which validity the institution that expresses the appraisal has to be obviously deemed responsible. In other words, in accordance with the ordinary rules of the obligation law shared by the generality of civil and common law countries, it seems probable to attribute to the appraisals of the matter a relevance which means a commitment of such truthfulness and effectiveness of the assessments, that agencies should be held for the civil damages of their conduct. The exigency to duly identify the sphere of civil liability of rating agencies is unavoidable according to the fact that these agencies are not only charged by the issuers (in respect of which they could be liable to a breach of contract), but – and apart from the entrusting with a specific task – take the liberty of giving “appraisal” on the issuing of any debtor, included sovereign state (unsolicited rating).

As a consequence, it is not easy to shape a contractual relationship if, lacking an explicit request of “appraisal”, it is not possible to identify a precise counterpart in condition to rightfully bring a lawsuit against agencies of this paper; therefore, there is the necessity, according to the doctrine, of using the concept of “social contact” liability (*responsabilità da contatto sociale*) in order to charge the institutions above of the effects of the conduct imputable to them⁶³.

In the contest above, it is necessary to identify limits of such agencies’ activity, since the theory, which puts into perspective the significance of ratings as mere opinions, assigning to them, either a descriptive nature, or an entirely

⁶³ See ROSSANO D., *Le agenzie di rating nel rapporto con gli investitori: profili di responsabilità*, in *Riv. trim. dir. econ.*, 2012, II, p. 52 ss.

without any prescriptive value, is not convincing⁶⁴. This theory – which compares appraisals of rating agencies to information of the financial press and tends to put them under the protective wing of the “First Amendment of the US Constitution which protects freedom of speech”⁶⁵ – in the past has been positively agreed by the US jurisprudence that, pursuant to the explanatory principle above, often denied the liability of agencies for appraisal turned out to be misleading; this defensive theory, rescuing these institutions from compensation of damages they were the cause of, led also to discouragement of issuing a “rating as much as possible faithful to the effective creditworthiness of the issuer”⁶⁶.

As regards the shaping of a conduct that is clearly in conflict of interest, this could be deemed as implicit in a situation where receivers are the same purchasers of the ratings, in addition to the particular structural situation that distinguishes the managing body of rating agencies, consisting of first-rank persons coming from financial and industrial market.

The clear conflict of interest, and more precisely the interlocking directorates, that can be identified in this situation, has been known for some years and subject to doctrine discussions, as can be deduced by some researches on this matter, issued by Supervisory Authorities of the financial market. We refer, in particular, to the publicly expressed fear that “rating agencies ratings would be made defective by structural problems, that comes out from relationships between issuers/originators and the same agencies and following conflicts of interest, both for the ‘monopolistic’ position of the agencies with respect to the

⁶⁴ See, for all, H. LANGHOR-P. LANGHOR, *The Rating Agencies and Their Ratings*, New York, 2008, *passim*, and in particular p. 40 and following.

⁶⁵ See HUSISIAN, *What Standard of Care Should Govern the World's Shortest Editorials? : An Analysis of Bond Rating Agency Liability*, in *Cornell Law Review*, vol. 75, 1990, p. 411 and following.

⁶⁶ See PARMEGGIANI, already mentioned, page 46; similarly, ENRIQUES, *Rating e regolamentazione*, speech during the seminar “*Mercati, agenzie di rating e regole: per un circolo virtuoso*”, at Università Bocconi of Milan (May 2010), p. 12 of Consob “*Documento*”, available on www.consob.it.

information on products and evolution of asset below quality”⁶⁷. This obviously changes into a loss of faith in agencies’ conduct⁶⁸, fed by several doubts on their operating methods⁶⁹, which are basically joined to the fact that “structured finance transactions generate fees equal to more than half of agencies proceeds and the assignment of a very high rating is condition essential to placement products”⁷⁰.

In conclusion, it seems to be unquestionable that, pursuant to the current regulation, there is a clear lack of balance between the position of entities, which provide the rating, and of other institutions, which concur with them in determining the level of reliability of subjects under appraisal (we specifically refer to auditors). In the system of liabilities there is no reason for the differences with respect solely oriented to control and appraisal actors of the market.

8. Apart from any technical consideration on (qualitative and quantitative) calculation methods and processes followed by analysts – and, consequently, on the level of reliability of such appraisals – it is undoubted that this activity cannot be taken out of control of Supervisory Authorities competent in countries where the activity subject to rating has been carried out, due to the influence on the market trends they can determine.

As a consequence, doctrine – referring to specific ways of regulation provided by different systems – has pointed out the negative influence due to the lack of specific regulation of rating agencies⁷¹. In such a context the critical ex-

⁶⁷ See CONSOB, *La crisi dei mutui subprime problemi di trasparenza e opzioni di intervento per le autorità di vigilanza*, edited by Linciano, *Quaderni di finanza*, n. 62, September 2008.

⁶⁸ See, among others, the editorial of *IlSole24Ore*, January 14, 2012, entitled *C’è qualcosa di marcio nello Stato dei rating*.

⁶⁹ See, among others, the editorial of *IlSole24Ore*, December 7, 2011, entitled *S&P, Moody’s e Fitch*.

⁷⁰ See CONSOB, *La crisi dei mutui subprime problemi di trasparenza e opzioni di intervento per le autorità di vigilanza*, p. 11.

⁷¹ On this matter, see the meaningful opinion of ANTONUCCI and PARACAMPO (in *Conflitti d’interesse e disciplina delle attività finanziarie: il titolo II della legge risparmio e le sue successive modifiche*, in *Banca e borsa*, 2007, I, page 326), according to which “Agencies... identify...

amination of agencies' conduct, carried out by recent statements of experts and politicians oriented to reduce their influence on financial system⁷², has to be arranged; this occurrence is due, among other things, to the fact that appraisals (the analysis regards, in particular, those of S&P), issued on Italy, influence the "sentiment of the market about the default risk of biggest banks... already in the month prior to the rating agency downgrade... (having)... incorporated the news... thanks to the review for downgrade and to the outlooks... that such agencies uses to communicate their intention of change rating"⁷³. This is the reason underlying some recent law proposals, in order to reduce such agencies' intervention⁷⁴.

The definition of appropriate measures will certainly allow such entities to recover their original function as cooperating entities helping the economic systems to perform well and hold steady. The ongoing Italian Parliament's discussion seems to be oriented in the same way, highlighting that: "credit rating agencies are an asset, and it is right ... (to make use of) ... the benchmark ... (they offer) ..., but because of the enormous power reached, such an activity shall be regulated. Independence, transparency and recognizable standards concerning who gives the opinion shall be set up urgently, but above all sanctions shall be set up in connection with those situations in which the abovementioned opinions have been evidently given in breach of certain rules"⁷⁵.

exemption areas from the subjective sphere of enforcement of EU (in particular, Directive 2003/125), and.... domestic regulation".

⁷² See critical opinions on rating agencies conduct of several members of European Parliament during 25 January 2012 hiring of "Economic and Monetary Affairs Commission" whose chairman was Zálba Bidegain; such opinions are available at the following link: www.europarl.europa.eu.

⁷³ See CAPASSO, *Le variabili che determinano i credit default swaps spreads: un'analisi econometrica della situazione italiana*, final thesis exposed at University Luiss G. Carli, 2012.

⁷⁴ See the editorial entitled "Ignorata la bocciatura di Moody's: finisce l'era degli oracoli del rating", edited on La Repubblica, February 15, 2012.

⁷⁵ See SENATO DELLA REPUBBLICA, 16^a Legislature – Meeting – Stenographical record of meeting No. 686, March 7, 2012. Consob's recommendation wishing for regulatory initiatives "concerning the credit rating agencies" in order to correct the lack of information came out during the financial crisis, should also be noteworthy. CONSOB, *La crisi dei mutui subprime*

Such positions, though in a delayed way, have drawn on the guidelines proposed by a CESR's consultation paper with references to the regulation of the credit rating agencies, by means among the others of their registration,⁷⁶ and previously (in 2002) by the European Commission (in the paper called "The European Union's first reply to the political issues raised by Enron's case") that expressed the need for the identification of appropriate measures to ensure a reasonable regulation of the credit rating agencies.

The cues contained in the US Dodd-Frank Act (D-F Act), enacted in 2010, could help to review the role of the credit rating agencies. The D-F Act entrusts the Office for Credit Rating, within SEC, with the analysis of the credit rating agencies and the verification of their internal control systems in order to counterbalance the references to such credit rating agencies set forth in the regulation and define alternative standards to measure the quality of the credit instruments⁷⁷.

The Financial Crisis Inquiry Commission's recent critical analysis with respect to the credit rating agencies is noteworthy, highlighting their "failure to perceive the losses that lay ahead"⁷⁸.

In the meanwhile, with specific references to the European regional context, consideration shall be paid to Regulation No. 513 of 2011 of the European Parliament amending the previous Regulation No. 1060 of 2009 on credit rating agencies that expressly stated that "[m]ost Member States do not regulate the activities of credit rating agencies" (whereas No. 2), whilst "certification should be possible after determination by the Commission of the equivalence of the legal and supervisory framework of a third country to the requirements of this

problemi di trasparenza e opzioni di intervento per le autorità di vigilanza, in *Quaderni di Finanza*, n. 62, September 2008.

⁷⁶ See *Position paper ABI* on «proposte del CESR in tema di regolamentazione delle Agenzie di rating», in *Bancaria*, No. 1/2005, p. 51.

⁷⁷ See AA.VV., *Regulating Wall Street. The Dodd-Frank Act and the New Architecture of Global Finance*, New York University, 2011, p. 453 and following.

⁷⁸ See WALLISON, *Dissent from the Majority Report of the Financial Crisis Inquiry Commission*, American Enterprise Institute for Public Policy Research, Washington DC, p. 24.

Regulation” (whereas No. 15). The new Regulation – in referring to the amendments occurring in the very top structure of the European financial system – has charged ESMA with the oversight activity on the credit rating agencies in Europe. Therefore the exact fitting of such activity with the markets’ recommendations and the need for a reasonable balance within each of the different financial systems will obviously depend on how the abovementioned authority would be able to define its own functions and areas of activity. Moreover, the ESMA’s Report concerning the first assessment on the credit rating agencies (published on March 22, 2012) leans toward the very same direction.⁷⁹ The Report points out that the analysis has been focused on three different evaluation parameters (sovereign states, banks and covered bonds) considered relevant on the basis of the current markets’ trend and that it is “a first step in an on-going supervisory process” given that the authority intends to run additional assessments during 2012.

Within the context of the represented renewal perspective, promoting (at least through the European Union) the alignment among the different legal frameworks concerning the referred entities, by means of the setting up of uniform standards, seems clearly advisable in order to avoid possible structural and operational differences among such entities. Discontinuities in the continuation of their activity, indeed, should be avoided even when they could be ascribed to the different legal systems of the countries in which the addressee of the opinions are based: fostering the alignment of legislations will ensure an easier monitoring of the credit rating agencies’ activity and, therefore, a better compliance of the latter with investors’ needs.

On the basis of the above, it seems impossible to agree with the opinion supporting the deregulation of the subject matter and suggesting the goal of “deleting any reference to rating in the context of the supervisory and regulato-

⁷⁹ See ESMA’s Report No. 2012/207.

ry provisions”, subject to the assumption of higher levels of responsibilities by “banks’ and investors’ risk management”⁸⁰.

Moreover, that solution involves some unchallengeable issues; if use of credit rating tools were deferred to an autonomous evaluation, then the complete deletion of the credit rating itself could not be excluded (at least in a borderline scenario); and, accordingly, the positive effects arising from the evolutionary process of the credit rating agencies could be practically erased too.

9. Provisions for any structured intervention supporting sovereign debt, either through the ECB or other organizations, would need to rely on strengthened instruments for verifying actions and results performed by the beneficiaries, in order to confirm and protect mutual commitments. The very moment when the international financial turmoil takes the form of a eurozone sovereign debt crisis can be well identified⁸¹ on October 6, 2009, as the new Greek Prime Minister G. Papandreou publicly rejected the official statistics on the Greek debt and deficit, reported in the context of the EU Stability and Growth Pact – Excessive Deficit Procedure⁸².

The confidence crisis that would follow also involved the EU’s ability to monitor the degree of achievement of agreed tasks. This deeply relied on recognizing the crisis of traditional instruments for the EU economic governance, as well as the induced proposals for law changes. In order to allow for coordinated interventions fully integrated into corrective mechanisms for the underlying imbalances, and therefore agreeable for financing states, three conditions are needed; they correspond to three steps of an integrated process for surveillance.

⁸⁰ See VELLA, *Una rivoluzione copernicana per il rating*, available at www.lavoce.info.

⁸¹ See NELSON, BELKIN and MIX, *Greece’s Debt Crisis: Overview, Policy Responsens, and Implications*. CRS Report for Congress, 2010, 14.5, p. 3.

⁸² See Council Regulation (EC) No. 3605/93 November 22, 1993 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

In the first place is statistical monitoring for the main macroeconomic aggregates and government finance indicators, in a framework of reliability and full transparency, able to prevent – or make extremely difficult – cases of misreporting such as the Greek one. A clear drawback in the EU statistical regulations referred to the lack of inspective powers for the EU Commission (Eurostat). Notably, Eurostat has not been in a position to directly access national basis data, or to carry out complete audit activities on national statistical authorities. An important change of stance in this context emerged from the Ecofin Council in June 2010⁸³, and resulted in new legal provisions, also included in the legislative package – the so-called Six Pack – approved by the European Parliament in September 2011. The Regulation on the effective enforcement of budgetary surveillance⁸⁴, that is part of the Six Pack, at Art. 8, foresees the Council, acting on a recommendation by the Commission, having the power to impose a fine on a member state that intentionally or by serious negligence misrepresents deficit and debt data relevant for the application of the EU budgetary rules. In addition, Art. 11 allows the possibility of the Commission adopting delegated acts in connection with sanctions concerning the manipulation of statistics, foreseeing strict procedures for investigations, inspections and fines.

According to the new rules, the statistical office of the EU shall be able to conduct on-site inspections and request information from all entities that have to be classified in the general government sector, both at central, state, local and social-security level.

In line with the new legal provisions, an internal reorganization was adopted by Eurostat, resulting in the creation of specific audit units, carrying out inspections on a permanent basis. Other interventions⁸⁵ referred to a common system of practices (European Statistics Code of Practice), and to a committee

⁸³ See COUNCIL of EUROPEAN UNION (2010), *Press Release* - 3020th Council meeting Economic and Financial Affairs, Luxembourg, June 8th.

⁸⁴ See REGULATION (EU) No 1173/2011 of the European Parliament and of the Council of November 16, 2011, on the effective enforcement of budgetary surveillance in the euro area.

⁸⁵ See COUNCIL REGULATION (EU) N. 679/2010 of 26 July 2010, amending Regulation (EC) n.479/2009 on the quality of statistics in the context of the Excessive Deficit Procedure.

for the statistical governance (ESGAB), intended to strengthen the integrity and independence of the European statistical system in the context of “peer review” foreseen by the Code of Practice. Of course, those interventions are a step in the right direction and are aimed at improving the integrity, transparency and reliability of the statistical information. However, it should be stressed that further substantial strengthening would be limited by the implied need to introduce significant changes in the main Treaty⁸⁶.

The second point refers to broadening the scope of surveillance: apart from strengthening the reliability of the statistical information on already used indicators (i.e. government deficit and debt), the need clearly emerged to measure all other elements able to timely signal potential imbalances in the member states. The Commission proposals, now included in the approved Six Pack⁸⁷, are aimed at improving the preventive arm of the Stability and Growth Pact, by introducing a wide “scoreboard” of indicators, able to identify elements of structural weakness, increase of systemic risks and competitiveness losses. Even in this case, while changes clearly go into the right direction, criticalities may emerge, referring to the wide set of indicators to be taken into account.

The current account, international investment position, and private debt, all included in the scoreboard, are indicators subject to high margins of estimates, and strongly depend on heterogeneous national practices (even though formally harmonized according to the EU rules). Those indicators, on the one hand valuable for the information content, are on the other linked to thresholds of precision and reliability not comparable to those achieved by the government finance indicators. For countries facing “significant” macroeconomic risks, a deeper analysis is foreseen, taking into account excessive increase in credit or financial assets prices.

⁸⁶ See EUROPEAN CENTRAL BANK, *“The Reform of Governance in the Euro Area: Main Elements”*, Monthly Bulletin, March 2011, p. 119.

⁸⁷ See REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention and correction of macroeconomic imbalances, (EU) No 1176/2011.

In such a context, a better solution would entail more elements able to ensure coordination and consistency with analysis and recommendations by the European Systemic Risk Board, in charge of surveillance over macroeconomic risks and financial stability at a European level⁸⁸. Finally, it should be stressed that this broadening of indicators would refer to an annual basis only. This frequency may be deemed as sufficient in the context of the preventive arm, in relation to the governance foreseen by the reformed Stability and Growth Pact (whose key steps are annual). However, in case of further strengthening of the governance, through stabilization mechanisms, this monitoring activity would be necessary even at an infra-annual level, in spite of the clear qualitative drawbacks of existing quarterly based statistics.

The third aspect, indeed the most difficult to be pursued, relates to a solid linkage between macroeconomic surveillance (the two points above) and interventions with the member states concerned. The Six Pack foresees the regular budgetary surveillance enforcing mechanisms similar to those used in the first decade of the monetary union, but with stricter rules (e.g. the reverse qualified majority voting rule). But the linkage between measured results and consequent actions may deserve further developments under use of the extraordinary mechanisms to be used in the context of the crisis. Any medium-term stabilization mechanism implies fiscal transfers, implicit or explicit, between member states. Such transfers may not be acceptable by the contributors, unless proper mechanisms exist, able to signal and measure the degree of achievement of the counterpart actions by the beneficiary, including effective adoption of reforms. Provision in this sense is included in the rules to be followed for the European Stabilization Mechanism (ESM), that will play a significant role in the new economic governance of the Union; notably via the “strict conditionality” of the adoption of adequate policy measures, foreseen as a counterpart to financing.

⁸⁸ See VISCO, I. “Rafforzare il coordinamento delle politiche economiche”, Chamber of Deputies, July 8, 2010.

The ECB shall be involved in the checking process, together with the EU Commission and the IMF.

It should be clear that such strict mechanisms cannot be identified in the case of the ECB's Security Market Programme, where no transparent mechanism existed, able to link favourable interventions with the effective achievement by the beneficiary. On the one hand, this may clearly depend on the exceptional circumstances and related need to minimize timeliness of responses; but on the other hand, it creates serious constraints to a process that need agreement in a wider horizon. This aspect concurs in qualifying interventions under the Security Market Programme as strictly temporary, due to lack of any structured mechanisms for implementing conditionality.

10. The crisis has highlighted the lack of intervention mechanisms to solve problematic situations related to specific EU member countries, without generating uncertainties, costs and lengthening the time of the revival. Actually, all the actions, which will be discussed below, have assumed an "extraordinariness" character and were not managed according to predefined rules, with an obvious increase in charges and determination of serious concerns about the markets.

In particular some interventions are considered that were carried out by the ECB and the creation of a special organization, the European Financial Stabilization Mechanism (EFSM), authorized to provide loans, using resources of the EU in favour of member countries in difficulty. Leaving aside here the evaluation of the criticisms made against such actions deemed contrary to the provisions of articles 123 and 125 of the Treaty on the European Union⁸⁹. As will be explained later, it is possible to refute any objections in reference to the ratio underlying EU legislation that assigns significance to the EU stability and to the proper functioning of the institutions involved.

⁸⁹ Making recalls on such judgments.

What is relevant here is the need, expressed by these interventions, to proceed with a renewal of the disciplinary criteria related to the European financial regulation, which need not be exhausted in the single determination of adequate regulatory mechanisms of cash flows, but which invests (as a priority in terms of time line) also the revisiting of “top management architecture” of that regulation field.

This explains why a head structure in the Community was created, equipped with significant powers of control and intervention, which should – in perspective – ensure systemic balance of complying countries. The structure in question is characterized by a strengthening of the supervisory framework (delegated to the Union) aimed at reducing the risk and severity of future financial crises; consequential appears, therefore, guaranteeing healthy growth conditions of complying countries, as a condition that can counter the crisis and allow a reduction of “sovereign debts”.

More specifically, in reference to the guidelines elaborated by the working Group led by J. de Larosiere, the creation was scheduled of a complex architectural framework above which there is a body – the European Systemic Risk Council (ESRC), headed by the President of the ECB – responsible for monitoring and assessing potential risks to financial stability arising from macro-economic processes and, consequently, skilled to enact inputs and guide-lines for the prevention of macro-systemic risks.

This organization has been joined by the “European System of Financial Supervision Authority” (ESFS), divided into a network of national authorities to cooperate with three new European authorities (EBA, ESMA and EIOPA) and foreordained to safeguard the soundness of individual financial companies and investor safeguard. Regarding in particular the banking sector, the supervisory authority (i.e. EBA) is provided with broad powers, not only aimed at developing and adopting supervision standards (articles 10 and 15 of Reg. n. 1093/2010 European Parliament and of Council November, 24 2010, establishing the EBA),

but extending to the adoption of decisions “against a single financial institution, requiring the necessary measures to comply with its obligations under EU law” (art. 17, point 6 of previous Reg. n. 1093/2010)⁹⁰.

The supervisory activity carried out by the new European System of Financial Supervisors should be given, on the one hand, on the homogenization of the practice of risk analysis and planning of control activities for all cross-border groups, and on the other, into micro-prudential level, to carry out interventions that assume, in essence, a role very close to that previously held by third level committees that have currently failed (actions that obviously have been subjected to careful review, joining the scope of the principles of subsidiarity and proportionality ratified in the Treaty).

On the level of concreteness, they have reached the conditions for a translation of national sovereignty in Europe (in addition to the monetary implemented in the past with the Treaty of Maastricht). It is a legal duty to check if the contribution of specific powers to the new European System of Financial Supervision allows you to configure in this case – rather than the mere creation of a “network” with a confined task of implementing authorities (through a co-decision of the existent countries in the indicated control structures) forms of homogenization and operational coordination – a real shift of powers, institutionally owned by involved countries, to new organisms that make up that system.

The significant number of duties and powers of the appointed authorities, and the role that they play in developing common standards and practices of regulation and supervision, would seem to suggest that the guidelines should be, precisely, in the direction of transferring within the European centralized essential part of the competence to give content to the action of public oversight of the economy.

⁹⁰See CAPRIGLIONE, *Le amministrazioni di controllo del mercato finanziario. La particolare posizione della Banca d'Italia*, in *Rivista trim. dir. econ.*, 2011, I, p.14.

Consequently, the national supervisory authorities, in the near future, should remain only the limited responsibility to make determinations of compliance (by operators) of the requirements imposed by the special discipline.

Hence the possible situations that will be given to a determined level of specific member countries in the presence of European interventions that affect the equilibrium laboriously pursued domestically. And in this regard, for example, we recall the setting of stress tests, within the Union, “to evaluate the strength of financial institutions” in the face of declining trends in markets and, therefore, “to evaluate the potential growth of systemic risk in situations of stress”⁹¹.

It is possible to outline, therefore, a reality that certainly appears still not yet fully clarified. Confirmation of this is the fact that in the framework of the financial authoritative European also involved institutions, such as the ECB, expressing interests sometimes not shared by the countries that have not joined the single currency. It is clear that – in front of a needed reassessment of the systemic forms of cohesion (based Union) to be implemented with a view to a deeper integration between the member countries – a loss of coherence becomes feasible in the construction in question, which is exposed to paradoxical behaviour (which is obviously the result of an arbitration logic inattentive to the implications of the adjustment processes).

Consequently, caution is mandatory in the evaluation of a phenomenon that, to date, can still be said *agani fieri*. It would be a dangerous mistake to believe the season for disciplinary reforms in question has ended, without having first been investigated by the appropriate verification (conceptual and operational) for leaks by a judge just now outlined.

The last consideration does not prevent confirmation that the institutional changes just now reported (coming into force in January 2011), as was antici-

⁹¹ See the example on EBA, 2011 Eu-Wide Stress Test Aggregate Report, available on www.eba.europa.eu. See also TROIANO, *Architettura di vertice dell'ordinamento finanziario europeo*, in AA.VV., *Elementi di diritto pubblico dell'economia*, edited by Pellegrini, Padova, 2012, p. 559.

pated, aimed at bringing life to organizations able to provide concrete answers to the questions raised by the cyclical nature of the market, and this by setting a control apparatus which should be able to prevent new crises through the provision of “correctives” proportionate to the difficulties which, in terms of concreteness, operators could meet⁹².

The manner in which it was intended to counter the progressive expansion of cross-border operations appears to be significant. This refers to the creation of an authority in charge of macro-prudential supervision, with a strong institutional anchor to the ECB and, therefore, the Eurosystem (identified in the particular composition of the decision body, previously highlighted)⁹³. The recognition of specific skills to the same (in analysis and risk assessments) ensure the stability of the financial apparatus, and the right to issue risk warnings and recommendations of several types (general and particular) which highlight the central role in redefinition of macroeconomic policy instruments with which to fight the risks of globalization process⁹⁴.

With the second pillar of the new architecture of the European financial framework, represented by a network of authorities responsible for the micro-prudential supervision, it is possible to remedy the main shortcomings of the previous structure. These authorities, which show substantial equivalence of goals and tasks, perform a function aimed at preventing regulatory arbitrage (pursued by careful efforts to strengthen the robustness, effectiveness and consistency of regulation and supervision), as well as control of the risks (implemented through constant monitoring of markets and financial assets) and the protection of service users (which is linked to a substantial obligation to crisis management and analysis of systemic stability).

⁹² See MICOSSI, CARMASSI e PIERCE, *On the tasks of the European Stability Mechanism*, in CEPS Policy Brief, n. 235, 8 March 2011.

⁹³ See Regulation 1092/ 2010 of the European Parliament and of the Council, 24 November 2010.

⁹⁴ See TARANTOLA, *La vigilanza europea: assetti, implicazioni, problemi aperti*, lesson, 8 April 2011 held at Università degli studi di Roma Tre, available on www.bancaditalia.it.

It is clear that the aim is to make the sector regulation increasingly close to the innovation of financial markets and to the changes in technical and operational intermediaries. This is a logical enhancement of cooperation between the authorities of individual member countries and coordination of their action on an international scale. More generally, it tends to reduce situations of uncertainty specification, thus limiting the moral hazard of operators, hence the further prospect of a favourable effect on countries' stability, which (as prospective recipients funds) will benefit from the selection of providers and the reduction of opportunistic behaviours.

In the specific context it is more important that the European Supervision Authorities (ESAs) are able to develop binding technical rules in areas authorized by primary legislation. Indeed, the definition of technical standards – regardless of the critical implications of which have previously said – is perhaps the most significant allocation of new supervisors, as instrumental in drawing up a discipline truly homogeneous (so-called single rulebook), and applied in a manner binding on all complying countries, would ensure the complete resolution of problems connecting to the supranational level and minimum harmonization.

At present, the recognition of the ESAs' regulatory powers is due to the Community regulation laying down the scope of its operations; it is also the Commission that adopts technical standards for the implementation of proposals developed by the ESAs; stopping the use of procedural devices (in emanation of standards) to prevent the micro-prudential supervisors is relegated to a position of mere technical expertise. That said, there is no doubt however, that – as has been said above – the proposals for technical regulations, elaborated in the relevant European, have reduced the margin of discretion of the individual national supervisors; this is an unavoidable consequence of the disciplinary system under consideration, although it amounts to a particular trait d'union between the European and national regulatory approach

and the adoption of any regulation is usually preceded by a period of public consultation and impact analysis.

Hence the possible conclusion that, while certain to be regarded as undeniable intrinsic limitations in the construction systemic highlighted just now, it is unquestionable that it constitutes a decisive contribution to the process of integration between the EU member countries. So, on a technical level, the conditions for a stable and efficient cooperation of member countries were determined in line with the half-century design that animates those who believe in a united Europe.

11. In response to the crisis, several forms of ad-hoc interventions have been designed, with the involvement of all European authorities. As from the second half of 2010, turbulence on the sovereign debt market developed in the euro area, dramatically increasing in 2011, with significant cases of contagion, even to governments not directly involved in intermediary rescue operations. Starting from the end of 2010, the European Central Bank adopted the form of “non-standard measures” including purchases of euro area government securities on the secondary markets.

From a legal point of view, those ECB interventions, even though indirectly in favour of sovereign securities, do not seem to require specific forms of regulation, as long as they refer to the conduct of monetary policy. The EU law, aimed at conditions of equilibrium and stability in the Eurosystem, does not prevent operations that, even though not explicitly foreseen (then “non-standard”), concur in pursuing this general scope.

Since operations under the Security Market Programme are carried out in the secondary market, they do not violate provisions in art. 123 of the EU Treaty, which prevents direct financing only (i.e. either loans granted to member states, or purchases of their bonds in the primary market). The relationship with art. 125 (no-bailout clause) is more complex. It prevents the Union from assum-

ing the commitments of governments, “without prejudice to mutual financial guarantees for the joint execution of a specific project”.⁹⁵ In legal terms, the operations under the SMP determine a credit position, not the assumption of debt as in art. 125. However, interventions in the economic literature pointed out that those interventions, notably if significantly increasing in size and duration, would imply an implicit form of bailout, contrary at least to the spirit of the law⁹⁶. Those aspects would add to doubts about effective sterilization of asset purchases, potentially interfering with the monetary policy stance. Most problematic aspects appear therefore to refer to “quantum” of the interventions, more than to their nature.

The official rationale⁹⁷ for the measures refers to the need of restoring the transmission mechanism of monetary policy, whose regular functioning is a precondition for the exercise of the tasks assigned to the ECB by the Treaty. The same measures may be interpreted as belonging to a wide range of devices that, at an European level, might be used in order to contrast speculative dynamics, implying stress on sovereign debt (and inter-bank) markets, related to uncertainty about the duration and efficacy of firewalls. Wherein interventions under the security market programme may be seen as a temporary firewall, able to limit tensions and undesired short-term spreads oscillations. As a side effect, those measures would also limit other forms of imbalances, such as those affecting the Swiss franc and the corresponding monetary policy.

The main problem implicit in the measure refers to the awareness of their end, beyond a certain time or size limit. This end would be implied either from the amount of resources that could be used without conflicting with the institu-

⁹⁵ Buiter e Rahbari gave a wide (and controversial) interpretation of “specific project” in art. 125, to include “A Project to Reinforce Sovereign Debt Sustainability”. See BUITER and RAHBARI, *The future of euro area: fiscal union, break-up or blundering towards a “you break your own it Europe”*, in *Citigroup Global Markets Global Economics View*, 9 September 2011.

⁹⁶ See BELKE 2010 *Driven by the Markets? ECB sovereign bond purchases and the Securities Markets Programme*. Policy Department Economic and Scientific Policies, June 8, 2010, European Parliament, Brussels.

⁹⁷ European Central Bank, *Statement by the President of the ECB* – Press release, August 7, 2011. <http://www.ecb.int/press/pr/date/2011/html/pr110807.en.html>.

tional tasks of monetary policy, or by difficulties in keeping the necessary political and technical agreement with all parties involved in the decisions. The already mentioned fiscal transfer (or cross-subsidy) hidden in the measures would relate to participation in the capital – then in the potential losses – of the ECB. Increasing positions in problematic assets would imply an implicit subsidy in favour of the issuer state from other member states participating in the ECB capital. Those latter are exposed “pro-quota” to the risks of capital losses, that would translate in terms of distribution of a decreased monetary income. The fiscal nature of those non-standard measures is an anomaly in relation to the tasks attributed to the ECB, and therefore it is not likely to be defended without limits. In addition, defending without limit the price of bonds under attack, even though optimal from the viewpoint of ex-post market stabilization, would create moral hazard and conflict of interest with regard to the adoption of adequate and rigorous budgetary policies.

After raising a number of reactions and doubts, the Security Market Programme seemed to abdicate in favour of other specific interventions at the end of 2011 (see below). However it may still create non-negligible effects on the Eurosystem’s balance sheets; in addition, it might restart at any time as a main option, in case of tensions not controlled via the other measures.

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At the end of 2011, in addition to a reduction of the key interest rates to 1%, the ECB launched a further package of three less usual interventions. One measure allowed banks to use loans (in addition to usual securities) as collateral with the Eurosystem: for given banks' balance sheets, this increases the amount of liquidity that can be taken from the ECB. Another unusual measure was to reduce the required reserves ratio from 2% to 1%, in order to free up the liquidity of the banking sector, making it available for money market activity and lending to the economy. The third measure was possibly the most important: the extension of central bank low-cost credit provision to very long maturities. This latter was a substantial re-interpretation of a pre-existing scheme for open market operations, the so-called "longer-term refinancing operations" or LTROs, with a maturity now extended to three years.

The official aim of these enhanced LTROs was "to give banks a longer horizon in their liquidity planning. (...) The goal of these measures is to ensure that households and firms – and especially small and medium-sized enterprises – will receive credit as effectively as possible under the current circumstances"⁹⁹. As a matter of fact, it was an unprecedented quantitative easing, injecting in two rounds more than one trillion euros in low-cost financing to eurozone banks for three years, and with the benefit of an opt-out clause after one year.

What is new in these enhanced LTROs is therefore the size and duration, never previously observed in the eurozone. This induces a subtle difference in comparison to pre-crisis LTROs. It should be recalled that, under normal condi-

⁹⁸ For technical details of such operations, see: *European Central Bank*, Monthly Bulletin, July 2011, pp. 57–72.

⁹⁹ DRAGHI, *The euro, monetary policy and the design of a fiscal compact*, Ludwig Erhard Lecture, 15 December 2011. European Central Bank, Frankfurt am Main; www.ecb.europa.eu.

tions, the Eurosystem's regular open market operations consist of one-week euro liquidity-providing operations. As a counterpart of the financing received, banks are required to provide the ECB with "eligible assets", used as collateral guarantee, until the loan is actually repaid. Through refinancing operations, the ECB steers short-term interest rates, manages the liquidity situation, and signals the stance of monetary policy in the euro area. In the past, such standard, short-term operations have been complemented by LTROs with a maturity of only three months, aimed at providing additional, slightly longer-term refinancing to the financial sector, able to allow for better management of maturities.

The new version of LTROs (i.e. increased in size and with an exceptional maturity of 36 months), instead of fine-tuning temporary liquidity mismatch, allows banks to get rid of their potentially problematic assets (used as collateral in the operation), and be protected from their market fluctuation in a medium-long term horizon¹⁰⁰. This now equates to providing insurance against the risk of tensions in the bond markets, which normally are an important source of long-term funding for banks, insulating most large banks from turmoil in the sovereign and corporate markets.

At first sight, those new measures' main official aim appears to be largely unattained: at least in late 2011 and early 2012 there is no evidence that the new financing has been actually used by banks to increase their lending to firms and households¹⁰¹. More encouraging results may be seen in the second, less emphasized scope implicit in the measures, that is alleviation of some important euro area governments' funding problems. This second aim was perhaps included in Mr. Draghi's general goal to restore "the functioning of the economy", but

¹⁰⁰ The ECB contracts of course foresee mechanism for the update of collateral before maturity. However, such mechanisms appear less problematic than the risk of market impairment under a confidence crisis.

¹⁰¹ See BELKE, *Three-Year LTROs – A First Assessment of a Non-Standard Policy Measure*, Policy Department Economic and Scientific Policies, April 2012 European Union, Brussels.

made explicit beyond any doubt by the so-called “Sarko Trade”, and publicly announced by the former French President¹⁰².

At a time when increasing positions under the Security Market Programme appeared unsustainable, and market investors were just betting on the closing date of the agreement, the new ECB measures were able to substitute for the programme and restore sovereign debt market conditions. Even though not associated with any visible increase in lending to the real economy, the measures broke the vicious circle between mounting sovereign risks, bank funding problems and deteriorating economic conditions, which were taking on a systemic nature. Euro-area banks’ medium-term financing risks declined sharply, most notably for credit institutions in the countries under the greatest pressure from the debt crisis, in line with their governments’ borrowing cost¹⁰³.

Compared with the security market programme, the new, extended form of LTROs is not less correct from a formal viewpoint. Actually, it is an instrument pre-existing to the crisis, and not an “ad-hoc” exception¹⁰⁴. In both cases, the interventions result in decreased tensions in the sovereign debt markets, even though the ECB’s first counterparty is never a government. However, the Security Market Programme was liable to be interpreted as indirect lending of last resort in favour of governments, notably in the presence of a significantly increasing stock of involved assets. Whereas the enhanced LTROs, even though they may easily result in banks’ decision to invest in sovereign debt, have a clear

¹⁰² See HUME, *How big could the Sarko trade go?* Financial Times Dec 15 “French President Nicolas Sarkozy said the ECB’s increased provision of funds meant governments in countries like Italy and Spain could look to their countries’ banks to buy their bonds. ‘This means that each state can turn to its banks, which will have liquidity at their disposal,’ Sarkozy told reporters at the summit in Brussels”. <http://ftalphaville.ft.com>

¹⁰³ See BANCA d’ITALIA, *Financial Stability Report*, Number 3. April 2012, website: <http://www.bancaditalia.it>. For an analysis of banks’ stock market performance and their exposure to the sovereign bonds in the context of the LTROs, see ANGELONI and WOLFF, *Are banks affected by their holdings of government debt?*, Bruegel Working Paper, 2012/7, March 26, 2012.

¹⁰⁴ “Incidentally, we want to make it absolutely clear that in the present conditions where systemic risk is seriously hampering the functioning of the economy, we see no stigma attached to the use of central banking credit provisions: our facilities are there to be used.” (DRAGHI, 2011).

and immediate beneficiary in the banking system; but lending to banks, even of last resort, by the ECB, does not raise specific issues. This holds even in cases where the banks' collateral is government bonds, rather than other assets.

It may be deemed a comparative advantage for big banks with a higher percentage of government bonds in their portfolio, in comparison to saving banks specialized in loans to small businesses (that may be used as a collateral too, but with a significantly higher haircut, up to 40% or more). However, those intermediaries' defaults would be likely to create fewer problems, in comparison with systemic ("too big to fail") operators. Other difficulties may refer to possible appreciation of the euro, as an unwanted side effect, able to spoil a firm's competitiveness; but this event was not observed.

Some observers still argue that, as a consequence of the extended LTROs, the ECB is still taking over credit risk, from counterparts unable to finance themselves¹⁰⁵. In addition, the overall risk incurred by the ECB would be higher, compared with risks incurred in the USA by the Federal Reserve in the context of two rounds of quantitative easing.

However, it should be stressed that the final risk incurred by the ECB does not equate to credit risk towards its counterpart, since the loans are granted by collaterals. Nor does it equate to the sovereign risks for bond holders. Indeed, the ECB's risk is linked to a complex, double event, implying banks' failure to repay and collateral default too. It is still true that an element of mutual insurance exists, implying implicit cross-subsidies between countries participating in the Eurosystem: losses arising from the LTROs would still be distributed between countries participating in the ECB capital, as in the case of Security Market Programme. However, the likelihood of the double events implying losses is lower, and the possible link with illegal government financing is weaker. In addition, continuation of the LTROs seems less subject to risks of policy disagreement:

¹⁰⁵ See GROS, *The Big Easing*, The European Voice, April 10, 2012 <http://www.europeanvoice.com>

knowing this in advance would create less perverse incentives to bet on the end of the measures (as might have been the case, instead, with the SMP).

The enhanced LTROs may prove a better instrument in comparison to the Security Market Programme, and create fewer problems. However, it may just decrease the probability of credit crunch, or make them less severe, but it is not enough to avoid one, unless other conditions apply.¹⁰⁶ This ECB's full-scale banking bailout seemed to provide impressive initial results, in terms of market stabilization and investors' confidence. However, it should be taken into account that it was not an isolated measure: actually, it was backed by a favourable context, with negotiations for the well advanced Fiscal Compact Treaty, and after pro-euro committed governments were in place in Spain and Italy. It is difficult to make a precise assessment of the enhanced LTRO alone, in case one of those accompanying elements are no longer in place.

Market tensions in April 2012, preceding the two-notch downgrade of Spanish bonds, confirmed once again that the turbulence was not defeated, and a possible new recourse to the Security Market Programme was re-launched by many analysts as an option. In the end the enhanced LTROs, though at once more powerful and less controversial, share the same nature as the SMP: they are valuable in mitigating the negative effects of the symptoms; but cannot substitute for recovery from illness. The latter might only be achieved through a deep process reforming the EU institutions and functioning.

13. The trade-off between efficacious solutions to the problem of the Eurosystem sovereign debt market stabilization on the one side, and the need to preserve correct incentives in the context of fiscal discipline on the other side, already discussed in the case of the Security Market Programme, relates to other forms of intervention as well. The European Financial Stability Fund

¹⁰⁶ See KIRKEGAARD, *"Europe's new fiscal compact treaty does not outlaw Keynesianism and is a stepping stone to more progress"*, February 6, 2012 <http://www.voxeu.org/index.php?q=node/7600>

(EFSF), as of the European Council decisions of July 2011, in addition to issuance of bonds and granting of loans to member states (already included in its original mandate), is entitled to perform interventions on the primary and secondary market of sovereign bonds¹⁰⁷. This latter activity might of course be used as a substitute for purchases under the Security Market Programme, but this would raise the same questions about the need for automatism of the mechanism (efficacious against speculative attacks), and the advantages of conditionality, required for prevention of opportunistic and profligate behaviours of the beneficiaries. Similar arguments would of course apply to the European Stability Mechanism (ESM), inheriting the tasks of the EFSF.

Other alternative proposals refer to the launch of bond of the Union (eurobond), in relation to which the above difficulties, about the need to keep mutual consensus, still hold, and perhaps have increased¹⁰⁸. In almost all the proposals in the literature on eurobonds – since the original one by Jacques Delors in 1993, to the most recent prepared by the academy and by policy makers¹⁰⁹, two features are common: in the first place, the guarantee granted by participating states is “joint and several”, rather than individual (as it is the case for EFSF)¹¹⁰; in the second place, the process is not reversible.

In comparison to the use of the EFSF-ESM, issuing eurobonds would imply a greater extent of integration between the euro area member states. This is

¹⁰⁷ See COUNCIL of EUROPEAN UNION, Brussels, 21.7.2011, Statements by the Heads of State or Government of the Euro Area and EU Institutions.

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/123978.pdf

¹⁰⁸ See COLOMBINI, *Crisi finanziarie. Banche e Stati*, Torino, 2011, p. 140, where it is clarified that *eurobonds* “unlike...government bonds, do not show an evident national connotation, being linked to the Union balance sheet”.

¹⁰⁹ See BOONSTRA, W.W. (2011), *Saving EMU -Central funding of public deficits, combined with a renewed Stability and Growth Pact, can stabilize the eurozone*. Rabobank Working Paper Series, No. 02- January; DUERING A. (2011), *A modest eurobond proposal*, Deutsche Bank – Fixed Income Special Report, 25 August; TREMONTI and JUNKER (2010), *E-bonds would end the crisis*, The Financial Times, December 5th.

¹¹⁰ In the few exceptions, it should be mentioned the proposal by PRODI e QUADRIO-CURZIO, 23 August 2011, where joint and several guarantees are replaced by conferrals of capital (EuroUnionBond, here is what must be done: <http://www.ilsole24ore.com/art/economia/2011-08-23/eurounionbond-here-what-must-084308.shtml?uuid=AazcQlyD>).

followed on the one hand by the impossibility of isolating individual positions (of course separable in the case of EFSF-ESM); on the other hand, by real participation in debt, that might be directly issued by the Monetary Union.

These elements may explain the difficulties that emerged in relation to this solution, even under dramatic market tensions such as those observed in the second half of 2011.

14. Recovery from Europe's illness or, even better, prevention of illness, closely relates to fiscal discipline, and deserves a special place in the EU legislation from the very beginning of single currency. However, the pillar of this discipline – i.e. the Stability and Growth Pact (SGP) – was not satisfactory: the Pact has been broken 60 times over the past 12 years and, even worse, no sanctions were ever enacted. In the specific context of the global economic and financial crisis, doubts about Europe's ability to monitor and prevent imbalances played an important role in terms of financial contagion. Market tensions in the euro area sovereign debt markets have put further emphasis on shortcomings in the governance of the Economic and Monetary Union. In this context, a reform package – the so-called Six Pack – was approved by the European Parliament in September 2011. It amended and strengthened the Stability and Growth Pact, with sanctions coming into force earlier and more consistently than before; it introduced a new Excessive Imbalances Procedure for the prevention and correction of macroeconomic imbalances; and laid down new requirements for member states' national budgetary frameworks.

The Six Pack was then accompanied by a second pillar of legislative response to the crisis, consisting of a re-design of the fiscal governance in the single countries of the euro area, and signed in March 2012 by all member states of the EU, except the UK and the Czech Republic. This treaty, referred to as Fiscal Compact Treaty, is a fundamental restatement of the rules to which national budgetary policies ought to be subject, to be adopted in the countries'

primary legislation. Some parts of the new act look like a mere restatement of previous legislation. However, substantial differences occur in two areas. The first key difference is the “debt brake”, a provision according to which euro area member states will foresee that the annual structural deficit should not exceed 0.5% of nominal GDP, and will implement such a rule in their national legal frameworks at a constitutional level. This would allow the avoidance of “excessive deficits before they arise, rather than trying to control them after they have emerged. Prevention is better than cure”¹¹¹. This rule, that basically refers to balancing between revenues and expenditures in the current period, has been complemented by a numerical benchmark for annual debt reduction to bring down debt levels accumulated in the past: those Contracting Parties whose general government debt exceeds the 60% shall reduce it at an average rate of one twentieth (also called the “1/20 rule”)¹¹². The second innovation is that the European Court of Justice, under the new treaty, will have the competence to verify the implementation of these rules at national level, and impose sanctions if it is believed that a member state hasn’t properly transposed the debt brake in the constitution or national legislation.

Criticisms of the Fiscal Compact Treaty may point to the ambiguity of some definitions: for example, that of “exceptional circumstances”, under which the Treaty would permit exceptional fiscal stimulus¹¹³. In more general terms, until the member states actually implement new rules in their national legislation, the coercive powers established by the Treaty are very limited. Concerning

¹¹¹ DRAGHI M., *Ludwig Erhard Lecture*, Berlin, 15 December 2011 (www.ecb.int).

¹¹² Article 4 of the Fiscal Compact makes reference to criteria for convergence as specified by Regulation 1177/2011, that states: “When it exceeds the reference value, the ratio of the government debt to gross domestic product (GDP) shall be considered sufficiently diminishing and approaching the reference value at a satisfactory pace in accordance with point (b) of Article 126(2) TFEU if the differential with respect to the reference value has decreased over the previous three years at an average rate of one twentieth per year as a benchmark, based on changes over the last three years for which the data is available.” <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:306:0033:0040:EN:PDF>.

¹¹³ Such circumstances can include an unusual event outside the control of the eurozone government concerned, but having a major impact on its financial position. Such circumstances could also include “periods of severe economic downturn”, causing a “temporary deviation” in the budget that “does not endanger fiscal sustainability in the medium term”.

sanctions that the European Court of Justice may impose, it should be stressed that the maximum fine that could be assessed is capped at 0.1% of GDP: this amount could not be regarded as a strong deterrent of poor implementation of the rules.

The real incentive is in fact provided by another provision, stating that member States have until 1 March 2013 to sign up to their obligations under the new treaty; otherwise, they cannot qualify for any new funding that might be required under the EU's permanent bailout mechanism, the European Stability Mechanism (ESM), which comes into effect in July 2012. The mandatory character of the Treaty would be seriously limited in important countries not depending on ESM funding, but nevertheless suffering from market tensions, whose consequences may extend to other countries, for example, France, where it is likely that the Treaty, if ratified, may only be implemented via a 'loi organique', that is without changing the constitution. This aspect leads to a paradox: on the one hand, the Treaty is seriously binding only for countries that depend on access to the ESM; on the other hand, those countries' access to funding through the ESM was already subject to strict conditionality of the adoption of adequate policy measures, under pre-existing rules (Six Pack). This point raises several doubts about the Fiscal Compact Treaty's usefulness.

As noted by D. Gros, the main value of the Treaty "is of course that it provides political cover for the German government in its efforts to sell the euro rescue operations to a sceptical domestic audience. (...) The main danger is that that it has been oversold. It does not constitute a first step towards fiscal or political union. It is likely that the ratification process (e.g. the referendum in Ireland) and then the implementation process in some difficult countries (e.g. France) will receive a lot of attention"¹¹⁴. With this regard, it should be added that the Fiscal Compact Treaty would not imply any specific and direct con-

¹¹⁴ See GROS D., *The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (aka Fiscal Compact)*. CEPS Commentary, Bruxelles, March 8th, 2012.

straint on member states' budgets until 2015.¹¹⁵ This means on the one hand that the Treaty should not be blamed for worsening the current economic situation; on the other hand that the Treaty may be effective in the short run to the extent that it is able to restore financial markets' confidence, making public finances in the euro area credibly robust. This aspect increases doubts about the choice to "oversell" provisions already included in previous legislation, but now incurring new risks associated to referendum and other ratification processes. Unnecessary occasions for "throwing again the dice" may just raise doubts on this commitment, counterbalancing the main positive effect on credibility. This may just result in unnecessary tensions in markets, with consequences not easily foreseeable.

A common criticism of the Fiscal Compact Treaty relates to the lack of legitimacy of solutions judged as "good outcomes" from a technocratic viewpoint, over inclusive democratic process¹¹⁶. More popular versions directly classify the Fiscal Compact in the range of the austerity policies being inflicted by Europe's financial and political elites, preserving banks' returns over public interest¹¹⁷. In the same vein, arguments have been used e.g. in the French electoral campaign, where politicians agreeing on austerity measures have been blamed for serving bankers' immediate priorities, instead of preserving the welfare system¹¹⁸. The above objections, as well as the possible perception of a trade-off between democracy and crisis management, could not be neglected a priori and should deserve proper attention.

It should be first observed that provisions aimed at limiting the borrowing of funds in future fiscal years, or promoting the balancing between revenues

¹¹⁵ See ROSSI S., "Audizione preliminare all'esame del Documento di Economia e Finanza 2012", 23 April 2012, available at www.bancaditalia.it.

¹¹⁶ For arguments from an USA perspective, see BERMAN, S., *Democracy, Banks, and the Current Euro Crisis*. *Global Policy Forum*, 2012, January 4 (www.globalpolicy.org).

¹¹⁷ See KUTTNER R. "Europe's Banks Versus European Democracy". *The Huffington Post Business*, Edition: US, April 29, 2012 (www.huffingtonpost.com). Similar arguments have been put forward in many European countries' political debate.

¹¹⁸ See MORRIS M. and ZEEB V., "A Pre-Election Analysis: Politics, Populism, and Le Pen", UCL European Institute, Comment and Analysis, April 18, 2012.

and expenditures, have been included in several national constitutions in the past, well before the adoption of the Fiscal Compact Treaty, and without raising similar criticisms. Examples are provided by art. 115 in the German Grundgesetz, putting a federal law reservation on any assumption of future commitments, or Art. 81 in the Italian constitution, aimed at foreseeing cover limits for expenditures¹¹⁹. Such constitutional rules have been voted under normal conditions, i.e. not under pressure from exceptional market tensions, nor under a state of “suspended democratic processes”¹²⁰.

An agreed definition of the “public”, or “general” interest (as opposed to “particular” or “elitarian”) is not available. However defined, public interest should be expected to satisfy a simple property, highlighted in the Rawlsian theory of justice:¹²¹ the rules should be apt to be agreed upon by parties knowing nothing about their particular abilities, tastes, wealth and position within society (appropriate decisions are then made under the “veil of ignorance”). It might be observed that, when inter-temporal choices are concerned, the correct use of the “veil of ignorance” paradigm would also require knowing nothing about the generation: i.e. rules should be agreeable by parties that do not know whether they will belong to the current, rather than to any of future generations. Under this condition, parties would not accept the risk of spending their life repaying burdens accumulated by previous generations. From this point of view, the Fiscal Compact Treaty’s provisions on current budget balancing, regardless of the process leading to them, should by no means be blamed for

¹¹⁹ The reform of article 135 of the Spanish constitution, which for the first time introduced the principle of budgetary stability into the fundamental law of the country, could not be used as an example of “spontaneous” adoption. Even though occurred before the adoption of the Six Pack, it took place in August 2011, i.e. under pressure deriving from the crisis. This does not apply to the articles of the German and Italian Constitution mentioned above. In this latter, article 81 dates back to 1948; a second, stronger version of this article was adopted in March 2013, in the context of the Fiscal Compact.

¹²⁰ See GURDGIEV C. *“Irish referendum a much-welcome test of the fiscal compact”*, in *The Global Exchange*, 2012, March, 5. See also BERMAN (2012).

¹²¹ See RAWLS J., *“A Theory of Justice”*, Cambridge, Massachusetts: Belknap Press, 1971. See also RAWLS J., *“Justice as Fairness: A Restatement”*, Cambridge, Massachusetts: Belknap Press., 2001.

serving particular, rather than public, interest. There is however one part of the Fiscal Compact Treaty that may be more controversial: i.e. the “1/20 rule” for annual repayment of previous debt. Choosing one twentieth – rather than any other ratio – may alter transfers of burden and benefits between generations, as well as between current classes and actors. This specific numerical benchmark was the outcome of bargaining between the heads of state and Government taking part in the March 2012 meeting, and could hardly be accepted – or rejected – in general terms.

In the end, the provisions in the Treaty, even though generating some procedural risks, may play a positive role in encouraging constitutional rules that would remain over time, and that could be hardly taken into account under normal conditions. In the long run, and combined with other interventions, this may be helpful for the destiny of the EU, though not decisive.

15. From the previous pages, it is clear that the events of “financial crisis” and “sovereign debts” affect the relationship between economics and law. At the European regional level, changes in order to remedy the regulations and, more generally, the political system is relevant.

In this regard, at the top of this process it is necessary to implement a cultural improvement that – to make the comprehension of certain onerous measures directed to pass through the financial crisis easier – makes it possible for the economic agere to improve without reducing the traditional moral “values” (freedom, equality, dignity, social utility). Indeed, the new European financial system configuration (already realized) and the introduction of adequate innovations (regarding techniques and procedures aimed to avoid the extravagances of maximum profit principles) require (each EU member country) to accept governance criteria of correctness, rigour and equality principles. This is the only way to reach the final goal of a better integrated European Union.

Actually, we are dealing with a situation where the paradigm of an economic power, intended as a prerequisite of development processes, has vanished. The economy has showed that it is not able to solve the several troubles of civil society and in particular to safeguard human dignity. The liberal theory, that in the last decades has supported (also thanks to the globalization process) the market economy system, shows its weaknesses. It has given way to a situation characterized by the risk of increasing financial losses, institutional troubles and, in general, by a sense of “lacking” and/or “confusion”, of which neither the market economy principles nor the state intervention can be a valid remedy. Fundamentally, it can be observed as an ethical-cultural decline that seems to be the negative outcome of an inappropriate interpretation of capitalism rules.

It is clear that the events cited in the previous pages induces better consideration of the market limits, the function that shall be attributed to law in the regulation of the latter and, in general, the possibility to propose a reconciliation among “business”, “finance” and “people” (core elements at all times related to any framework based on an agree that is able to join economic rationality and solidarity principles. Urgent and serious doubts have to be, consequently, solved about the ability of the economic system to regulate itself, and upon the sustainability of mechanisms that, even though formally structured to prevent declining phases, end up wasting the wealth produced due to their inappropriate use.

The crisis has shown that the pursuit of continuously rising profit levels – obtained with ruthless company policies and without respect for society core “values” – resulted in an effective model opposing the community spirit. In this context, it is not possible to obtain adequate equality levels. On the opposite side, the economic setting has let the already existing imbalances inside states and between states themselves to deepen. So we have had the worsening of

laissez faire trends and – also because of regulatory shortcomings – the grim situation described above¹²².

Without doubt the observance of guidelines inspired by “standards of social responsibility” are the first step for emerging from the recession. As a consequence, it could make the ultimate goal of a proper common growth project closer. Such a project, of course, will need a common effort from all member states and financial contributions (on a proportional basis), avoiding dangerous shortcuts.

Underlying the change is, therefore, the need to achieve the widespread belief that should soon change unacceptable conduct, which are obstacles for the development and stability of economic systems. A new *forma mentis* has to characterize the status of European citizens: maturity, seriousness, balance, awareness of the benefits that come from a proper act are its components.

Consequently, the fight against tax evasion and tax practices circumventing the impositions should take a leading role in the identification of behavioural guidelines to implement the “common good”. Likewise, the spread of corruption which, unfortunately, has become a sad plight in many countries, to which it brings disrepute as well as obstacles in the economic development and growth, should be resisted by every means. Addressing and deleting the “grey areas” of civil society, and pinpointing and fighting the so-called industry sector of the crime must be considered the essential objective to achieving a change for a sound economic recovery.

It is clear that the action of governments (at the level of individual countries) must be oriented in this direction. This is the way to accept the challenge of a renewal function that is proposed to correct the critical-induced degenerative forms of an advanced capitalism. It goes without saying that the adoption of other measures that serve to overcome the crisis (in the first place: the spend-

¹²² Ref. *supra* paragraph 4.

ing review and the reduction of what is of dubious significance) could find a suitable match on the overall humus that a careful policy will be able to achieve.

This is the essential prerequisite for ensuring, within the European region, progressive levels of “growth” and the right conditions for a successful process of joint development with regard to the whole EU. We need to look, therefore, for a joint provision of resources (by all member states) and must ensure that there are no falsehoods on the part of the economically strongest. A common desire to continue to stay together should guide EU countries in the belief that this choice offers benefits. Of course, the guidelines to be followed can be deduced from virtuous countries (notably Germany) capable of indicating, by their example, the way ahead.

If this result is reached, it should be seen as possible to overcome the logic of previous individualistic and, therefore, the opening of European countries to behaviours that conform to a spirit of solidarity, unlike previous experience. Attaching a necessary connection between freedom and solidarity is a prerequisite for putting on an objective basis the construction of democratic systems-oriented moral and civil progress. This process is possible and necessary if we want to build a system that reconciles democracy and integration.

Of course, we must clarify the meaning to be attached to the term solidarity: this cannot be interpreted with regard to its sociological and ethical sense, to justify the request for financial assistance to virtuous states. In particular, it is impossible to imagine a reality in which – in the face of irresponsible conduct (of certain political and commercial classes) that have caused forms of impoverishment and discomfort – some countries are required to participate with continuity and an abundance of financial resources to remedy actually disaster (caused by governments that have not been able to correctly interpret their role).

In this last case it would be a form of incorrect solidarity which certainly appears too far from the contents of the Christian *caritas*, “extraordinary force,

which drives people to be courageously and generously involved in the field of justice and peace”, as Pope Benedict XVI has recently consistently reaffirmed¹²³. This formula is indicative of a great challenge (which identifies the possibility of achieving development goals in the sharing of assets and resources), but does not justify the disengagement of somebody as regards the seriousness of others.

Therefore, solidarity shall not be tout court entreated by countries facing serious hardship to benefit in some way from financial statement amounts from others collected at the same time, who have demonstrated thriftiness and discipline. The well-known La Fontaine’s fable “The ant and the cricket” once again explains to us that such expectations cannot be proposed, as well as easily refutable!

Conversely, the recall to solidarity between peoples is, in our opinion, full legitimization of a meritocratic context (consolidated by a behavioural austerity and rigour) in which, however, some countries, for several contingencies, can be involved in a situation of temporary and sporadic trouble, which needs to get out to choice external interventions, as regards to others’ support!

16. From previous sections it follows that, in order to reconcile firewalls against speculative attacks on the sovereign debt markets with correct incentives for fiscal discipline, new rules of economic governance are needed, able to prevent imbalances and strengthen supervision over member states’ macroeconomic policies. Only a stronger economic governance revision in the euro area would efficaciously contrast tensions against the member states, perhaps exacerbated by the current situation with a centralized monetary policy and mainly de-centralized, albeit closely coordinated, national fiscal policies¹²⁴. On such a framework, corresponding to the difficulties originally met by the countries signing the Maastricht Treaty, is based an economic and legal situa-

¹²³ Ref. *Caritas in veritate* Encyclical.

¹²⁴ See ECB, *Economic Bulletin* July 2008 pp. 71-85.

tion where limited integration between member states is met by a permanent trade-off between attempts to avoid further transfers of sovereignty (i.e. other than monetary policy powers) and aims towards an efficacious mechanism for the functioning of the monetary union.

Provisions for strict conditionality, as with those mentioned in relation to the eurobond and the EFSF, would be prerequisites for mutual insurance through common funds, and would make a campaign of interventions in favour of countries subject to speculative attacks acceptable to virtuous countries.

Selecting an appropriate set of indicators, on which centralized interventions would be based, seems to be key, taking into account that the market judgements and reactions might not be able to properly capture the “fundamentals” of the involved national economies. Even though in a different context, this would be in line with a statement made by the ECB before the sovereign debt crisis: “not least due to short-termism and the herding behaviour of investors, the discrimination between risk characteristics of national government debt by financial markets tends to be imperfectly reliable and often incomplete. To compensate for these features, there is a clear complementary need for a collective fiscal framework that limits the issuance of national government debt”¹²⁵.

A centralized mechanism able to actually validate or correct in advance the member states’ fiscal policies would be needed, in line with statements by the European Council of the Heads of State and Government¹²⁶. An economic governance reform actually able to timely identify and oppose deviating conducts would also allow it to act as a device for re-conducting market evaluation in accordance with the economic fundamentals, alleviating the single countries’ exposure to idiosyncratic attacks. This would imply a further positive effect relating the central role of financial markets in assessing the national fiscal

¹²⁵ See EUROPEAN CENTRAL BANK, *One Monetary Policy and Many Fiscal Policies: Ensuring a smooth Functioning of the EMU*, July 2008, p. 71.

¹²⁶ See COUNCIL of EUROPEAN UNION, cit.

policies, that would benefit from the analysis of specialized authorities. This would also decrease the monopolistic powers of markets to decide the destinies of states, and this by itself would reduce risks arising by biased, speculative conduct. As we have seen in the previous paragraph, those general and desirable properties for a European economic governance have been only partially addressed by the legislative act defining the Six Pack and the Fiscal Compact.

17. It should be also taken into account that the existence of a fair, timely and really effective fine mechanism is an element that may induce virtuous countries (naturally less inclined to provide assistance to those deviating from discipline) to accept common policies for the defence of sovereign debts. Fines are already foreseen by the enhanced the Six Pack¹²⁷, but still in the context of the traditional Stability and Growth Pact. With the aim of improving the fostering of the convergence processes, in the Six Pack the amount of the fine comprises a fixed component equal to 0.2 per cent of GDP, and a variable component proportional to deviation from reference values. Revenues from fines should be assigned to stability mechanisms to provide financial assistance, created by member states whose currency is the euro in order to safeguard the stability of the euro area as a whole. The fact that fines relate to how serious the infringement is, and that the corresponding revenues enter a financing scheme devoted to countries complying with recommendations, may also be interpreted as an element of fairness. However, the most serious incentives might be provided in an alternative and more advanced framework, by controlling the distribution of financial resources, in the proposals foreseeing centralized funding only.

The work of the task force led by the President of the European Council, Van Rumpuy, as well as the European Council meeting following serious epi-

¹²⁷ See Regulation (EU) No 1173/2011 of the European Parliament and of the Council of 16 November 2011, on the effective enforcement of budgetary surveillance in the euro area.

sodes of turbulence on sovereign debt markets in the summer of 2011¹²⁸, as well as the German-French proposal¹²⁹ of 16 August 2011, clearly indicated a harmonization of fiscal policies and strengthening of the European governance as a priority¹³⁰. The outcome following a long process of agreement between EU institutions was a package that included many compromises. A new framework with centralized mechanisms for stabilization, together with an efficacious reformed economic governance for the EU, should be accompanied by a re-design of the role of the main European institutions: notably the European Central Bank, and its mandate's limits, which should allow for consistent interventions without raising doubts of illegal behaviour. In this context the lessons from criticisms raised in 2011 in relation to the Security Market Programme should be recalled; such interventions were regarded as a serious anomaly, with the ECB at risk of becoming the EBB (European Bad Bank)¹³¹. As already observed in relation to bank supervision, the ECB mandate might be enlarged and updated, in order to make its new tasks explicit and transparent without disagreement. Such coordinated changes would imply a new formula for a European "economic constitution" that, as opposed to the mere predominant position of some member states, would confirm the rationale of a regulated market assigning explicit influence to countries able to associate with their economy size, and the ability to maintain their fiscal discipline (depending in turn on political stability). The concept of mutual assistance might be revisited and used as a foundation, to the extent that it would not be intended as a permanent subsidy to the same country, but as a device that could in principle benefit any country experiencing an "idiosyncratic shock".

¹²⁸ See COUNCIL of EUROPEAN UNION, Quot.

¹²⁹ See M. MOUSSANET, *Merkel-Sarkozy: un governo per l'euro e tassa sulle transazioni*, in *Sole 24 Ore*, 17 August 2011, p. 9.

¹³⁰ See EUROPEAN CENTRAL BANK, *"The Reform of European Governance"*. Monthly Bulletin, March 2011, pp. 105-126; p. 117 and footnote 15.

¹³¹ In this light, see the declarations expressed by the former German member of Executive Committee of the ECB, Mr. J. Stark (in *Corriere della Sera*, 23 August 2011).

It is recognized by one of the regulations included in the Six Pack that “Experience gained and mistakes made during the first decade of the economic and monetary union show a need for improved economic governance in the Union, which should be built on stronger national ownership of commonly agreed rules and policies and on a more robust framework at the level of the Union for the surveillance of national economic policies”¹³². The recent reform of the economic governance, as well as the Fiscal Compact Treaty, are steps in the right direction. However, a truly effective adoption of this idea would be possible under more advanced institutional solutions.

18. The preceding analysis – regarding the financial crisis and sovereign debts that in recent years have particularly hit the countries of the eurozone – has attempted to show the difficulties that currently face the Eurosystem, fueling unmitigated euro-sceptical orientations and, therefore, proposing significant doubts about the validity of a “single currency”.

The present state of uncertainty and difficulties with the beginning of recovery – in which an obstacle is the current recession and the wicked game of grim speculation that leads to the resistance of some states – give substance to the debate at the core of which are the unacceptable delays of politics. To the latter is attributable in primis the inability to adopt ‘guide lines’ able to adequately support the economic growth; with respect to the Mediterranean countries this aversion to politics is shown in modality particularly that moves from disaffection traceable in a few (in the case of Italy) to forms of domestic insurrection with others (in the case of “Athens disorders”). Certainly, it can be said that there was – in some countries – an inappropriate interpretation of the role of politics, which presently has determined forms of unjustified dependency, and now has assumed positions of pernicious laxity, and far from necessary

¹³² See COUNCIL REGULATION (EU) No 1177/2011 of 8 November 2011 amending Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure.

rigour that must characterize a government action oriented to growth and equity.

These considerations reveal a scenario characterized by tax evasion, corruption etc., which do not create optimism but generate fears about a fast recovery and the achievement of balance and stability. Consequently, a socio-economic context characterized by inevitable negative consequences regarding the foundations of civil and democratic life has emerged.

On the other side it can be noted that, against the spread of market powers (definitely favoured by the globalization process), it has become increasingly urgent to revise the regulation of financial activity in order to define a cleaner discipline of individuals that, with their action, may affect market performance heavily influencing the market trends. Therefore, the reconciliation to specific forms of public control of each activity that interacts with the financial one is, now, a fully perceived requisite with regard to the rating agencies (whose judgements, often unsolicited, are frequently used by speculation); in the same way the opportunity, at the European level, to extend the supervision to the so-called shadow banking system is also recognized. As recently underlined by the President of the European Central Bank, the aim is to address by proper regulation and supervision all serious sources of systemic risks¹³³.

In the context of institutional reforms, in the last two-years there have been significant changes of the apex apparatus of European financial system. The creation of new bodies of control equipped with specific competences and powers should ensure, in future, more unity in the supervision action, especially through the limits of the latter with the verifications of macro-prudential systemic risks; these lines of positive evaluation are in contrast with the delicate interpretative questions of the intervention area of these authorities, hence the

¹³³ See EUROPEAN CENTRAL BANK, Speech by Mario Draghi, President of the ECB at the Sixth ECB Statistics Conference, Frankfurt am Main, April 17, 2012.

need to enable more adequate forms of coordination between the same and the corresponding administrations of national control.

In the same way, of relevance are the particular operations of extraordinary finance that, since the summer of 2011, the ECB has been carrying out in order to restrain the speculative attacks on the euro and, therefore, in view of more suitable market stabilization. Consequently, the effectiveness of these interventions (and further measures, currently still under examination at a technical level, in which the aim is to realize the commitment to avoid the degenerative effects of sovereign debts crisis) seems essentially linked to the innovation of the role (*rectius*: functions) of the central bank itself. Hence the perspective of redefinition of the institutional status of ECB, further to which it is possible to hypothesize lines of more cohesion within the EU; there is the possibility that, along with the expected introduction of a Fiscal Compact (directed at homogenizing the tax policies of member states), there could be a modification of the fundamental criteria of the Union, also involving the structural characters of the latter, returning the foundation to the common politics intention of member countries. This is, perhaps, the big opportunity that can be derived from the crisis!

To hypothesize that Europe – in the case of the creation of the eurobond and in the case of a renewed ECB with regard to the possibility of freely adopting measures of monetary politics – may be put in conditions that permit the implementation of an expansive policy based on rigour represents a recurrent idea in the auspices of those opposed to the break-up of the euro. In the same way, the need that with rigour must be also linked the program of growth is shared at a general level, becoming an inevitable condition of any proposition directed at strengthening the European Union.

The analysis carried out leaves hopes the prerequisites to exit from the uncertainty of the present remain. In this context, the experience and capabilities of virtuous countries must be of guidance in that process, as well as the

common awareness that this is the way to proceed in order to reaffirm a democratic capitalism, able to contrast with the power of oligarchic aggregations (at multinational level), which benefit from the degenerative events (financial turbulences, anti-politics, increase of inequality, etc.) of globalization.

WHAT MAKES A BANK A “SUSTAINABLE BANK”?

Roger McCormick*

“Events over the past couple of years have raised profound questions about the ways in which banks and businesses contribute to society. For both to play their full part, they must restore trust and become better citizens in a publicly demonstrable way.... Our focus on Citizenship is not for the short term; in fact, it is how we expect to make our business sustainable over the long term”¹.

“....our work towards becoming the UK’s most Helpful and Sustainable bank has...been recognised.....”².

“Stephen Cecchetti, chief economist of the BIS....said five years after the financial crisis engulfed the global economy, the world appears no closer to finding a sustainable economic model. Not until regulators get to grips with the banking system’s woes by forcing banks to recognise losses, take write-offs and raise capital can the path to sustainable growth begin, he said”³.

ABSTRACT: *The notion of sustainability has been used in several contexts in order to denote, in general terms, a reconciliation between the needs of the present and the needs of the future. In the specific context of banks and financial markets this concept needs do be further analysed, looking at possible solutions and criticalities (like those linked to the eurozone crisis and to politicians’ short term interests). In the specific case of banks, an honest recognition of losses is key, as well as the search for clear and publicly available information on balance sheets. This latter would help understand to which extent banks have changed their “bad habits”. Suggestions for improvements are then provided, aiming at information that enable verification, and include proper indi-*

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¹ Statements taken from the Barclays PLC 2011 “Citizenship Report”.

² From the RBS Group 2011 “Sustainability Report”.

³ From a report in the *Financial Times* of June 25th (Global economy stuck in “vicious cycle” of debt reduction, says BIS”, by NORMA COHEN). The comment accompanied the publication of the BIS’ 2012 annual report.

cators of sustainability, for banks' own business and for the overall financial system. The use of "soft-low" pressure may be an appropriate choice to bring about changes.

SUMMARY: 1. Introduction. - 2. A stormy month. - 3. UNEP FI and sustainable development. - 4. Sustainability and citizenship reports of banks. - 5. Independent assurance statements. - 6. suggestions for improvement; taking "bank sustainability" seriously.

1. This article is about banks, the financial markets and sustainability. In particular, it is concerned with how the modern notion of sustainability fits in with what banks do, what society wants them to do (to the extent society is capable of expressing a view) what activities are financed by banks and how banks and financial markets are organised. It suggests that although sustainability has, perhaps inevitably, become an elastic and over-used term, there is now a strong case for being more precise about what it encompasses (and does not encompass), particularly in relation to reporting requirements....and particularly in relation to reporting requirements for banks. At the centre of the debate is the question: what do we mean when we refer to "sustainable banks" and "sustainable banking"?

The Brundtland Commission of the United Nations⁴ famously defined sustainable development in 1987 as development that meets "the needs of the present without compromising the ability of future generations to meet their own needs". The concept of sustainability thus involves striking a balance between the needs of the present and the needs of the future. Examples abound. Timber production should be managed in a way that does not result in the rainforests being stripped bare, with potentially appalling consequences for the environment as a whole (not merely a shortage of timber for future

⁴ The formal title of the Commission's report is "*The Report of the World Commission on Environment and Development: Our Common Future*"

generations). Fishing policy should not allow over-fishing that could result in endangering entire species of fish. Energy policy should recognise that the supply of carbon-based fuel is not infinite and that alternative sources of energy need to be developed for the future. And so on. The idea of balancing the needs of successive generations fairly is sometimes referred to as “inter-generational equity”.

Against this background, it comes as no surprise that awareness of the need for “sustainability” is generally regarded as highly desirable. Politicians and businesses alike give the impression that they make common cause with environmentalist campaigners on the subject. Policies of any kind (whether or not directly concerned with the environment) are, if disliked, often criticised for having “unsustainable” aspects and, conversely, if liked, regarded as having “sustainable” qualities. It is hard to get through the day (if you are at all exposed to the modern media) without hearing “sustainability” and “sustainable” being mentioned many, many times. (Unfortunately, not always in a way that suggests that the word is being used for purposes that go beyond the decoration of an otherwise anodyne sentence).

Sustainability is thus a contender for “word of the decade” – perhaps several decades. As such, it merits close attention as to its use and meaning. In what follows, particular concerns are explored in connection with its meaning in the context of financial markets and institutions. How has the idea of “sustainable finance” (or “banking”) been developed as at 2012? The question is a pressing one, as the financial turmoil engulfing the eurozone and other parts of the world shows no signs of abating. As Patrick Jenkins (writing in the Financial Times “Sustainable Banking & Finance”⁵ supplement of 14th June) put it:

⁵ *The International Finance Corporation/Financial Times “Sustainable Banking Awards”* were presented at a gala dinner in London on June 14th.

“At a time when several eurozone governments are battling to restructure their budgets and make their debt burdens more manageable, the topic of sustainable finance could hardly be more pertinent.”

But what is “sustainable banking”? Is it the same as “responsible banking” --- the title of a Times newspaper lead editorial on 29th June?⁶ Is it related to the “culture” of banks themselves (whatever that may be), or is it more concerned with how banks use their financial power, the role they play in the “allocation of capital” in a global market? Are these, in reality, two distinct areas of concern or are they so closely linked that they should be considered together? Whatever may be the answer to such questions (which we will consider below) they clearly share the same practical difficulties insofar as they raise issues that are both inter-national and inter-generational. As a result, traditional (national) legislative measures --- which emanate from legislative bodies populated by politicians whose agendas are dominated by national, and usually short-term, interests are unlikely to be the source of a complete solution.

2. June 2012 (the time of writing) raised environmental concerns in the public consciousness in the most direct and fundamental way as it brought with it (in Europe) a truly appalling spell of stormy weather that made many of us wonder whether climate change was bringing a “rainy season” to replace what we had previously thought of as “summer”. It also brought (following hard on the heels of a G20 Summit in Mexico) the second Rio “Earth Summit” (formally entitled the “United Nations Conference on Sustainable Development” or “Rio+20”). In a speech given on 12th June, Christine Lagarde, the Managing Director of the International Monetary Fund, said, in relation to the Rio conference, that “we will be journeying back to Rio to affirm our commit-

⁶ This editorial was a comment on the “LIBOR rigging” scandal, referred to in footnote 18 below.

ment to sustainable development – the idea that we should strive for economic growth, environmental protection and social progress at the same time”.

Europe continued to endure further chapters in the ongoing eurozone crisis, with new bail-out measures (of the order of 100bn euros) being tabled for Spain (following the collapse of its biggest bank (in terms of domestic business), Bankia), a request for a bail-out by Cyprus and a return of “unsustainable” borrowing costs for certain eurozone countries. Commentators digested remarks from Mario Draghi, the President of the European Central Bank, in an interview published on the last day of May, that indicated he thought the euro system had become “unsustainable” unless national governments took further (unspecified) action), and there was a knife-edge re-run of Greece’s General Election that resulted in the party that had roundly rejected the terms of the country’s bail-out coming a close second (and, eventually, a coalition government being formed that then pledged to renegotiate a bail-out deal signed only a few months earlier).

In the UK, in the first part of the month⁷, the government published a White Paper⁸ on important bank reforms (mainly on the topic of “ring-fencing” retail banking from investment banking (or “utilities” from “casinos”) that was sub-titled “delivering stability and supporting a sustainable economy” and, in the first of his Reith Lectures for the BBC⁹, the historian, Professor Niall Ferguson, appealed for greater inter-generational equity and asserted that current practices in government accounting are “fraudulent”:

“There are no regularly published and accurate official balance sheets. Huge liabilities are simply hidden from view. Not even the current income and

⁷ The last week of the month was dominated by the *LIBOR rigging scandal* – see further below.

⁸ Cm 8356. The White Paper does not refer to the “sustainability” of banks as such – but it does refer to the need for UK banks to be “more robust” and “resilient, stable and competitive”.

⁹ Delivered at the London School of Economics and broadcast on 19th June 2012.

expenditure statements can be relied upon. No legitimate business could possibly carry on in this fashion”.

The essence of Professor Ferguson’s complaint, however, was not merely the dubious accounting practices but also the fact that modern representative government, especially when accumulating debt, does not look beyond the interests of the current generation of voters:

“The heart of the matter is the way public debt allows the current generation of voters to live at the expense of those as yet too young to vote or as yet unborn”.

Those suffering as a result of extreme “austerity programmes” introduced around the eurozone in order to allow governments to gain access to bail out funds to refinance unsustainable debt might be inclined to nod in agreement. Campaigners for “sustainable development” (see below) likewise. However, although Ferguson suggested that ordinary businesses could not be as unreliable in accounting practices as governments, he should perhaps have made an exception for banks, since his remarks carried echoes of an article published earlier in the month (5th June, in *Economia* magazine) by Andrew Haldane (executive director of bank stability at the Bank of England) when, calling for reforms to bank accounting, he said that accounting rules should “properly recognise the special characteristics of banks’ assets and liabilities” and that: *“to provide point valuations of banks’ assets, as at present, is to ask auditors to pin the tail on a boisterous donkey”.*

Various recent statements from regulators and others about banks’ balance sheets and solvency, particularly in the eurozone, could lead, were it not for depositor guarantee schemes, to a sharp loss of confidence on the part of the average citizen as to just whom you can believe any more. In his Mansion House speech (14th June), Mervyn King (the Governor of the Bank of England) remarked that, in the euro zone:

“...liquidity is not the issue, because after a few months [following the ECB’s one trillion euro liquidity programme (known as LTRO –long term refinancing operation)] we are back to where we were. The problem is one of solvency.

Where there are debtors who cannot afford to repay, there are creditors who will not be repaid. Until losses are recognised, and reflected in balance sheets, the current problems will drag on. An honest recognition of those losses would require a major recapitalisation of the European banking system.”

The appeal for an “honest recognition” implies that what we have at the moment is, shall we say, not entirely honest. Could it be perhaps that many banks hold large quantities of eurozone sovereign debt on their balance sheets? And that these “assets” (along with others, such as property loans that have become subject to excessive “forbearance” on the part of a lender that does not want to face reality) are perhaps valued rather optimistically? Is there, furthermore, an unhealthy commonality of interest between regulators who are subject to political pressure and the banks themselves to continue viewing such “assets” as though the euro crisis had never happened? The absence of clear, publicly available, information leaves us with no choice but to speculate¹⁰. But the sweeping downgrading of 15 major bank credit ratings carried out by Moody’s on 21st June suggests that speculation of this kind may not be very wide of the mark¹¹. As the calls for the use of public money to buy

¹⁰ The apparently chronic difficulty in coming up with clear numbers is reflected in a comment about the Spanish banks made by the economist, Nicholas Spiros, and reported in the Daily Telegraph on 22nd June: “In the space of a fortnight we have gone from a euro 37bn forecast for Spain’s capital needs in a stressed scenario to a euro 52bn, to a euro 52bn one. This begs the question – what will the more detailed audit in September reveal?”

¹¹ The report in the Independent newspaper said that: “Moody’s downgrades came amid fears that the euro crisis will prompt another credit crunch by making banks afraid of lending to each other, or anyone else.” The UK government had apparently already anticipated such developments when arranging for the Bank of England to make available £100bn of cheap credit lines to UK banks for the express purpose of on-lending to UK borrowers (announced in the Chancellor’s Mansion House speech, 14th June).

eurozone government bonds continued¹² – with the purported aim of lowering borrowing costs – the risk of such assets continuing to be given an inflated value only seemed to increase.

It looks like a vicious circle (or, perhaps, cycle)¹³. Some have called it the “bank-sovereign-bank doom loop” and suggested that many sovereign states are now becoming “aid junkies” as the number of bail-outs (for states or for banks), actual and predicted, keeps increasing. Has the financial system got hooked on bad habits?¹⁴ Does our approach to bank supervision work at all without the use of subterfuge and obfuscation? To take one example, the vast majority of European banks have now passed the European Banking Authority’s stress tests for two years running (including, infamously, the Irish banks that collapsed with a few months later). If Mervyn King is right, one might

¹² See, for example, the remarks of Christine Lagarde reported in the *Financial Times*, 22nd June: “Christine Lagarde, the IMF chief, said eurozone leaders needed to prevent the single currency from deteriorating further by considering the resumption of bond buying by the European Central Bank and pumping bailout money directly into teetering banks.”

¹³ The *Euro Area Summit Statement* issued on 29th June began by saying: “We affirm that it is imperative to break the vicious circle between banks and sovereigns”.

¹⁴ The business of banking, the selling of securities issued by banks (or governments) and the potential for political interference makes for a dangerous cocktail. Various episodes in the creation and downfall of the Spanish bank, Bankia, reported in a damning article in the *Financial Times* of 22nd June (“The bank that broke Spain” (Mallet and Johnson)) provide an illustrative case study. “Bankia was floated on the basis of unaudited accounts – “due to the recent creation of the Bankia Group”, the prospectus said – and it was eventually Deloitte’s refusal to sign the 2011 accounts that prompted the government’s intervention...” Although the risks were explained in the prospectus, the “euro 19bn hole” evidently took everyone by surprise. There was also, according to the authors, a shortage of “experienced top executives” – at least initially, until some of the investment banks involved in the IPO threatened to withdraw. “And when foreigners shunned the share offer, senior members of the government called the heads of Spanish banks and corporations and strong-armed them into buying 40 per cent of the euro 3bn worth of shares “in the national interest”. Retail clients across Spain –some 35,000 of them—were persuaded to buy the rest.”

Further, the regional savings institutions (“cajas”) that were grouped together to form Bankia “began as regional businesses and were in most cases closely connected to politicians in the areas where they operated.” The article suggests that the cajas generally were ill-equipped at managerial level to deal with the financial crisis that resulted from the collapse in Spanish property values. ““Fifty per cent of the banking sector in Spain –which was the cajas—did not have the corporate governance or the management skills to withstand a crisis” says one of the many investment bankers involved in the July 2011 public offering of Bankia”. On 4th July 2012, the Spanish High Court announced a fraud investigation into matters related to the Bankia flotation.

wonder just what the point of those tests actually is. They are hardly a persuasive advertisement for the latest¹⁵ proposed “solution” to the euro crisis; a European “banking union” with centralised supervision¹⁶. More importantly, as one looks at the current position, when a political leader tells us (as such leaders are wont to do) that his country’s banks are “strong” and do not need rescuing, should this now be taken as an early warning sign that they are on the point of collapse and in urgent need of yet more bail-out funds from the public purse (whether provided directly or indirectly)?

All this tells us that we have to be sceptical about what we are told about the financial position of banks. But even if we could trust “the numbers” that banks and regulators present to us, we know that they do not tell us anything like the whole story. Whatever new laws, regulations and codes of practice are passed, will the banks try to find ways round them and “game the system”? Will they honour the spirit as well as the letter of the law? How can we know if banks have changed since the crisis? Have they started to take ethics and morality more seriously? Do they look at their long term sustainability or are they still blinded by a desire for short term profit at any cost? Do the remuneration packages of senior executives still provide all the wrong incentives? These issues go to behaviour and attitude. If these have not changed, we can expect the “bad habits” that brought us the financial crisis in 2007 to give us a re-run before too long. If banks continue to operate within amoral or immoral culture zones, the lack of responsibility that ensues will infect the financial system itself, as graphically demonstrated by the LIBOR

¹⁵ Having been trailed for some weeks beforehand the idea seemed to take hold at the EU Summit meeting at the end of June, with commitments being announced to have some kind of cross-border, eurozone supervisory authority to be given to the European Central Bank by the end of the year (thus paving the way for bail-outs to be given to banks directly rather than via government balance sheets).

¹⁶ King was reported to have made the rather dry comment on this proposal: “Having one overall [eurozone] supervisory authority that didn’t have political commitments to individual banks might be an advantage from our point of view” (*Financial Times*, 30th June 2012)

rigging scandal that surfaced in late June 2012¹⁷, which succeeded in shocking an already sceptical public and resulted in calls for resignations, police investigations and public enquiries. The question of bank culture¹⁸, and how to correct it, has now become urgent for any financial market centre that values its reputation.

We can, of course, find any number of statements by senior bankers that tell us they have learnt their lesson and “turned the page”. We can see the growth of new committees and changes to organisational structures that suggest that changes are happening. But how can we verify that all this is not just window-dressing? After all, they have fooled us before...

3. As the eurozone continued to struggle with its apparently intractable problems, many of the world’s politicians and environmentalists, concerned about sustainability, were converging on Rio. Of course, the agenda was dominated by traditional “ESG”¹⁹ issues but the financial sector was able to make its voice heard (although not by saying very much about the financial sector itself). The United Nations Environment Programme Finance Initiative (UNEP

¹⁷ See *FSA Final Notice*, FSA ref:122702, regarding a fine imposed on Barclays “for significant failings in relation to LIBOR and EURIBOR”. The fine of £59.5m was the largest ever imposed by the FSA and related to apparent attempts to “rig” the LIBOR rate during the period 2006-8. Other penalties were imposed at the same time by US regulators. The day after the fine was announced, there was a significant fall in Barclays’ (and other banks’) share price (Barclays falling nearly 16%) and many calls (including from the Financial Times) for the resignation of Barclays’ Chief Executive and/or Chairman. (The Chairman eventually announced his resignation on 2nd July but the following day the Chief Executive and another senior officer resigned and the Chairman said he would stay on to help find a new Chief Executive). Many commentators speculated that the “rigging” practice complained of was not confined to Barclays and this seemed to be confirmed by the FSA saying that it was still investigating other institutions. The Chairman of the House of Commons Treasury Select Committee said that the committee would be looking into the matter, commenting, “the corporate governance of Barclays needs scrutiny. We intend to provide it...” The front page headline of the Financial Times for the day after the scandal broke (29th June) was “Barclays firestorm rages”.

¹⁸ Space considerations do not permit any consideration in this article about the deeper implications of the “culture” question or, indeed, what is really meant by “culture”. For consideration of some of the historical perspectives, see the author’s article referred to in footnote 21 below.

¹⁹ Environment, Social and Governance.

FI) describes itself (in a “Position Paper presented at the 2012 Rio conference) as “a global partnership between UNEP and the financial sector” which is “member-driven” and “voluntary” (with over 200 members). The initiative is based on the UNEP Statement of Commitment by Financial Institutions on Sustainable Development. The “commitments” in question (set out in the UNEP Statement) include a number of statements of belief and opinion rather than undertakings to do (or not do) anything in particular. For example, the first “commitment” is:

“We regard sustainable development – defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs – as a fundamental aspect of sound business management”.

Any “commitment” in the above statement is, at best, implicit and, as a result, somewhat imprecise. The second “commitment” states that the UNEP FI members “believe that sustainable development is best achieved by allowing markets to work within an appropriate framework of cost efficient regulations and economic institutions” and that “Governments have a leadership role in establishing and enforcing long-term priorities and values”. No “commitment” in the ordinary sense is contained in this statement, which, at least in part, seems to reflect the bankers’ desire for free markets. In fact, the only clear commitment – such as would be recognised as involving a promise of some kind – is a commitment to comply with the law. The members state (in paragraph 2.2 of the Statement) that they “will comply with all applicable local, national and international regulations on environmental and social issues...” When it comes to going “beyond compliance”, however, the Statement simply says that the members will “work towards” integrating environmental and social considerations into operations and business decisions. (For the sake of completeness, one should add that there is a promise to “endeavour to pursue best practice in environmental management” and to

“seek to form” relationships with counterparties that have high environmental standards - although not to the exclusion of relationships with counterparties that do not).

Perhaps one should not expect too much. At least the banks that have committed to the Statement recognised that “sustainable development is an institutional commitment and an integral part of our pursuit of both good corporate citizenship and fundamentals of sound business practice.” We will look into “good corporate citizenship” in more detail below.

The “common vision” shared by UNEP FI members is (they say) that sustainable development can only be achieved with “a stable and sustainable financial sector” as the “backbone” of a “more balanced, inclusive and green economy”. So the Position Paper for Rio 2012 should, one would think, be very aware of the decidedly unstable conditions prevailing in the financial sector as at June 2012. One might expect that any paper or “commitment” on sustainability by or on behalf of the financial sector would evidence such awareness. This, however, does not appear to be the case. The Position Paper consists of six short paragraphs, mainly exhortatory in nature and encouraging the “governments of the world” to do various things (including, it would seem, providing unspecified encouragement and incentives for the financial sector), and a summary of what the authors regard as desirable “key outcomes” for the Rio conference. These outcomes (which “governments” are asked to consider) are:

Highlighting the role of the financial sector, having regard to “its ability to promote the allocation of capital to those businesses and market players operating more sustainably”;

incentivising financial institutions to “integrate sustainability issues into their risk management policies and overall decision-making procedures”;

promoting “the availability and accessibility of relevant and comparable sustainability information”;

committing to “work closely with the financial sector in building markets for long-term sustainable lending, investment and insurance services...”; and

calling for “all UN-embedded and UN-backed partnerships with the financial sector and the broader private sector to work closely in order to enhance their efforts in making sustainable finance a reality”.

Of the above, the most interesting is 3). The text describing the detail of the “outcome” is unusually specific. It tells us that the objectives are to include:

“Facilitating access to information on relevant sustainability-related norms and regulations, as well as on their enforcement”;

“Developing a convention that provides a global policy framework requiring the integration of material sustainability issues within the corporate reporting cycle on a “report or explain” basis”; and

“Encouraging the regular evaluation of the sustainability impacts of commercial and residential properties....”

If the objective of improving access to information on sustainability-related norms could be achieved and the result was the availability of information about “ESG performance” that was both accessible and “comparable” (enabling one to compare one institution with another) we would have taken a major step forward. The public would be able to compare companies (including banks) with one another in a way that does not require the filtering out of the inevitable value judgements that tend to come with data and assessments produced by NGOs currently. The difficulties caused by the absence of objective indicators in this area have been commented on in an article published by the author earlier this year.²⁰ However, the main focus of UNEP FI, it seems, is looking at potential investee companies of all kinds from the point of

²⁰ “*Towards a more sustainable financial system – part 2: Creating an effective civil society response to the Crisis*”. (2012) 6 LFMR (at 200).

view of a financial sector investor (e.g. an investment manager or analyst). It is not directly concerned with the sustainability issues that are peculiar to banks.

It would seem that the “outcome” referred to above is reflected in part in paragraph 47 of the joint government statement (“The Future We Want”) issued at the end of Rio+20:

“We acknowledge the importance of corporate sustainability reporting and encourage companies, where appropriate, especially publicly listed and large companies, to consider integrating sustainability information into their reporting cycle. We encourage industry, interested governments as well as relevant stakeholders with the support of the UN system, as appropriate, to develop models for best practice and facilitate action for the integration of sustainability reporting, taking into account the experiences of already existing frameworks, and paying particular attention to the needs of developing countries, including for capacity building”.

This, in turn, was accompanied by a press release by a group of governments (Brazil, France, South Africa and Denmark) calling themselves the “friends of paragraph 47”, that committed to “advance corporate sustainability reporting”. It would seem that these governments are looking to promote a “report or explain” approach, as currently applied in Denmark and South Africa – although, at the time of writing, the precise scope of their work remains unclear. What does seem to be clear, however, is that Rio+20 has not resulted in any initiatives that are specific to the sustainability of banks or the financial markets – or the sustainability reports of banks. This suggests that the meaning given to “sustainability” at ESG fora such as those gathered at Rio is narrower than one might have hoped.

But notwithstanding the lack of interest at Rio + 20, perhaps the time has now come for such matters to be looked at more closely? Do sustainability reports of banks, for example, serve a useful purpose? Could they be made more useful if they provided, for example, more material that enabled the

reader to make a judgement about the culture of the bank and how it compares with its peers?

4. To study a bank's sustainability report is to study what a bank says about itself. It is not, to any material extent, a study of objective, and verified, data save to extent that certain data in the report may, in somewhat obscure language, be the subject of a limited form of assurance by an independent third party set out at the end of the report. Still less can it be considered a study of a bank's culture, although a comparison of a report with known facts about a bank's behaviour can be instructive.

No one could criticise the banks for shrinking from the task of presenting material about how sustainable they consider themselves to be. The difficulty arises when one tries to analyse the large amount of material made available, separate the hard facts from the statements of opinion, acknowledgements of room for improvement (which tend to be scarce) from self-acclaim (which tends to be plentiful) and find any kind of data that enables one bank to be compared with another. There is also, in the post-financial crisis world, a serious shortcoming that such material needs to address: the absence of any significant information that enables one to assess the sustainability of the bank in question as a viable, long term financial market participant and contributor to society and its stakeholders -- and form a view about its culture and its approach to ethical questions (evidenced by practice rather than stated policy). According to the Financial Services Sector Supplement ("FSS") of the Global Reporting Initiative ("GRI"), "Sustainability reporting is the practice of measuring, disclosing, and being accountable to internal and external stakeholders for organisational performance towards the goal of sustainable development." However, in practice, sustainability reports of banks are far from consistent about how the latter part of that phrase (which is, admittedly, somewhat imprecise) should be interpreted and this lack of consistency

makes analysis of the reports, and the comparison of one bank with another, difficult.

To illustrate the extent of the difficulty, it is instructive to compare the 2011 Reports of two of the UK's largest banks, RBS Group and Barclays (both of whom signed up for the UNEP FI statement of commitment referred to above). Although they cover similar ground, the two reports have different names: the RBS report is called a "Sustainability Report" whilst the Barclays report is called a "Citizenship Report". RBS focuses its document around "five sustainability themes": "fair banking"; "employee engagement"; citizenship and environment"; "supporting enterprise"; and "safety and security". Barclays' "citizenship commitment" is based on "three pillars": "contributing to growth"; "the way we do business"; and "supporting our communities". Many of the predictable themes can be found in both documents. These include, for example: "stakeholder engagement", combating financial crime, the bank's carbon footprint and general impact on the environment, governance structure, lending to small and medium-sized businesses, inclusiveness, diversity, the ever-widening range of "corporate social responsibility" and so on. Much of this material appears to seek approval for the bank doing little more than what the law requires anyway or for simply following sound business practice in its choice of borrowers or treatment of retail branch customers. It's not that treatment of retail customers is unimportant, it's just that at times these reports stray too far into "customer relations" (or just plain "PR") territory and, as a result, leave the reader feeling somewhat sceptical as he reads lengthy accounts of how wonderful the bank thinks its service is²¹. RBS, for example, tells us that it is working towards "becoming the UK's most Helpful and Sustainable Bank" and that its progress on this has "been recognised externally

²¹ Admittedly anecdotal evidence arising from the author's conversations with bankers, journalists, academics and "sustainability professionals" suggests that there is a widespread (but rarely openly expressed) view that documents of this kind are "just PR" and not to be taken seriously. Of course, if a bank regarded its own sustainability report as "just PR" that would itself seem to be prima facie evidence of a dubious culture.

through the awards we have won for our branch network, our call centres, our new mobile apps, our online service and our products.” Barclays tells us that it goes “beyond regulatory requirements to ensure the best experience for our customers” and even uses its document to advertise what are essentially investment banking services when, under the heading “Supporting the Eurozone”, it tells us:

“We continued to help government borrowers during the difficult conditions experienced in 2011. We also provided strategic advice, including advising the French state on the restructuring of the Dexia Group, the Spanish government on the valuation of its domestic savings banks, and the Bank of Ireland on a restructuring programme for the banking system”.

There are also references to the bank managing bond issues for eurozone governments. One begins to wonder if there are any aspects of the bank’s business that would not qualify for a mention in the report.

RBS, however, is prepared to address some business model issues in its document and provides a table of “key financial targets” for the bank, which includes statements such as:

“We want to put our balance sheet on a more secure footing by lending only as much as we have in deposits”;

“We want to reduce our reliance on short-term money market funding to make our balance sheet less volatile”²²; and

“We want to hold strong liquidity buffers to guard against unexpected funding difficulties”

These statements, and others in the document, tell us that RBS sees its own business model as a sustainability issue. This is to be welcomed. It is not clear that this is the case with Barclays. One would think that a bank (or any-

²² The *Banking Reform White Paper* (see fn 8 above) suggests that, in future, retail banks should not be dependent on wholesale funding: “Reducing reliance on wholesale funding is a way of ensuring that ring-fenced banks run less risk of funding and liquidity shocks, such as those experienced in the recent crisis”.

one else) that is serious about sustainable development would recognise that a sustainable financial system is needed if it is to be achieved and that a sustainable financial system depends, amongst other things, on banks learning the lessons of the global financial crisis and adopting sustainable business models themselves and converting to a more responsible culture than the one that dominated in the pre-crisis period. You might therefore expect a bank's report that deals with "sustainability" (whatever its title) would say something about the sustainability of its business model and ability continue in business without needing more taxpayer support than is implicit in depositor protection schemes and "lender of last resort" functions at the central bank. But such matters (which, as indicated above, are outside the scope of ESG, as traditionally understood) seem to slip under the radar of the traditional sustainability community and no pressure seems to be exerted on banks to develop such matters in "sustainability reporting".

Neither bank has anything to say in the document about its regulatory disciplinary track record (for example, how much it has been paying out in fines to its regulators) but both banks tell us about how they are getting on in dealing with customer complaints. In each case, the data about complaints are not presented in a way that enables progress (or the lack of it) against previous periods easy to assess (although Barclays produces a table for its UK bank that shows an improvement over 2010) and the information is unhelpfully laced with an excess of self-congratulatory prose. A statement of the bald facts followed by reasonably objective comment would have been better.

In both cases, complaints about mis-selling payment protection insurance (PPI) – a major, and expensive scandal for all the large UK banks --- loom large (although neither bank informs us in the document of the massive provision it has had to make for claims). In the case of RBS (which owns NatWest as well as other UK high street banks), the next report will no doubt have to comment on the severe problems encountered during week following 19th

June 2012, when a computer upgrade problem (widely referred to as a “technical glitch”) caused severe payment difficulties for its customers over a period of several days. This caused the Times newspaper to reflect on what society expects from banks in an Editorial on 25th June:

“For their customers, all banks are too big to fail. The systems meltdown at NatWest...was not just a commercial failure.

It left up to 16.9 million people surviving a weekend without cash, holidaymakers stranded, and account holders finding that payments were not made and paychecks did not arrive. In a handful of cases, families have been left living out of hotels as actual house purchases have stalled....

Just as the first duty of the state is to defend its people, the first duty of a bank is to provide a means whereby customers can get hold of their own money. All else is secondary....When a bank’s computers grind to a halt, rendering it an institution into which money can neither go in, nor come out, the blame can go nowhere else. This is rank incompetence”.

A serious operational failure, such as that which afflicted RBS can inflict serious reputational damage. Since banks depend on their reputation as a safe home for our money (whatever we may think of “bankers” these days) even a major bank like RBS can only afford a limited number of “technical glitches” of this kind before its business (and its viability and sustainability) is threatened. RBS will no doubt survive this incident but it will have to spend a great deal of time and money dealing with the ensuing avalanche of complaints and claims. UK banks may also find that they have to report next year on how they have handled claims regarding the mis-selling of derivatives to small and medium-sized businesses (SMEs), the subject of an FSA “update” statement at the end of June 2012²³. Are these sustainability issues? If “fair banking” and “good corporate citizenship” are, one would think so.

²³ This was entitled “Interest Rate Hedging Products, Information about our work and findings” and stated that the FSA investigation into the alleged mis-sellings had found “serious failings” in the methods used to sell the products to SMEs. The failures included: poor disclo-

The interesting, wider point is that issues such as how a bank handles complaints from its customers (and how many complaints it gets) are seen as a sustainability (or citizenship) issue by banks themselves. If that is the case, then surely data on fines for regulatory breaches (or sums paid in settlement of regulatory proceedings) in relation to matters such as insider dealing and other kinds of market abuse²⁴, lax controls to discourage rogue traders or other operational risks (including computer failure), poor anti-money-laundering procedures, failure to protect client money etc., should also be fed into the mix and an appropriate section be included in the Sustainability Report (in addition to anything reported elsewhere)?²⁵ Disciplinary action by regulators, after all, could be regarded as a form of “complaint” but made on behalf of the public as a whole. Further, many may feel that a bank’s disciplinary record (particularly if it is out of line with its peers) tells us more about a bank’s “culture” and ethical behaviour than any number of organisational charts, grand-sounding “sustainability committees” or statements of pious intent from the Chief Executive or Chairman²⁶. Let’s bring these things out into the open. (In many countries the raw data are in the public domain anyway). To paraphrase

sure of exit costs, failure to ascertain customer’s understanding of risk and “non-advised sales straying into advice”. There was evidence that financial incentives for the sales people were a driver of the poor practices.

²⁴ Again, the *LIBOR rigging scandal* provides an example. On 27th June 2012, it was reported that (according to the BBC News website) Barclays was fined £290m for “trying to rig” the LIBOR interest rate over a period of several years. The statement from the US Commodity Futures Trading Commission said: “Barclays.... attempted to manipulate and made false reports concerning both benchmark interest rates to benefit the bank’s derivatives trading positions by either increasing its profits or minimising its losses. The conduct occurred regularly and was pervasive”.

²⁵ *The FSSS of GRI* requires (at PR9) disclosure of the “monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services”. In relation to this item, both Barclays RBS simply state “NR” (not reported). No explanation is offered.

²⁶ In order to provide a reasonably comprehensive picture, it is suggested that the figures include sums paid in settlement of regulatory proceedings (a very common occurrence) and sums paid to third parties on the instruction of a regulator. Arguably, egregious losses due to poor risk management or controls and sums paid to tax authorities in recognition of a breach of undertakings relating to tax avoidance should also feature. The figures should be presented on a five year rolling basis so that the reader can judge more easily progress (or deterioration) over a representative period.

Barclays, a good “corporate citizen” should be aware of, and prepared to publish its history on such matters and ensure that its governance and controls result in a record that does not cause embarrassment.

In other areas, the contents of the Barclays and RBS documents tend to reflect different emphases and experiences of the two banks. Barclays, for example, has a great deal to say about tax avoidance – a subject that has given rise to some concerns for it in 2012 (and which, in June, received much attention in the UK media, thanks to a campaign by the Times newspaper that “exposed” the tax avoidance schemes entered into by various celebrities and induced the Prime Minister himself to pass judgement on the morality of the schemes). Barclays make some reasonable points about tax avoidance and there is at least a suggestion that they are changing their ways²⁷. It is a pity, however, that they insist on referring to tax paid by their employees (through the PAYE system) as though it was a contribution to society by the bank itself. RBS, on the other hand, provides a separate document on its financing of the energy sector which incorporates environmental data on “the activities and impacts of large companies worldwide” obtained from Trucost and enables RBS to boast, for example, that “we estimate that our top 25 power clients and top 25 oil & gas clients are less carbon intensive than the industry average”. Both banks state that they comply with the Equator Principles and both break down their EP (i.e. project finance) deals by risk category, but without any indication of the amount involved or any information that would enable a given project to be identified. Barclays gives us data on all its energy, mining and comparably environmentally sensitive finance deals that have been sub-

²⁷ For an article suggesting the links between the “celebrity tax avoidance” story and Barclays see Philip Johnson “A penitent comic offers lessons to shameless bankers” in the *Financial Times*, 26th June 2012. Stephens notes that Barclays, and its CEO, Bob Diamond, were annoyed that the UK tax authorities had named it as being involved in a tax avoidance scheme to which it objected and “as a result, the bank suffered reputational damage. This was especially galling as it had just started marketing itself as a good corporate citizen. Given the controversies of the recent past, including a shareholder revolt against Mr. Diamond’s £20m-plus pay and benefits package, it is moot whether Barclays has anything much of a reputation to be tarnished”.

ject to its internal screening process but nothing that would enable the reader to carry out any kind of verification.

5. A comparison of the Independent Assurance statements in the two reports raises some interesting points of comparison. According to the FSSS of GRI, such a statement should (inter alia) “assess whether the report provides a reasonable and balanced presentation of performance, taking into consideration the veracity of data in a report as well the overall selection of content”. The statement for the RBS document (made by Deloitte LLP) says, in the relevant part that:

“RBS have implemented processes and procedures, as described on page 39, that adhere with (sic) the principles of inclusivity, materiality and responsiveness as set out in the AA1000 Accountability Principles Standard 2008 (“AA1000APS”); and

“Nothing has come to our attention that causes us to believe that the selected key performance data which we were engaged to provide assurance on are materially misstated.”

To understand the above statements, one does of course have to read page 39 of the report and also look at the key performance data on which the “limited assurance” is given. Page 39 simply describes the AAA1000 Accountability Principles Standard and the three principles (of inclusivity, materiality and responsiveness) that “an organisation should adopt as a framework for sustainability management and reporting”. “Inclusivity” is expressed to mean “Identifying and engaging with stakeholders to gain a full understanding of issues”. “Materiality” means “Determining what issues are important to RBS and our stakeholders”. And “Responsiveness” means “Responding to material issues and being transparent about our performance”. So, one can conclude, Deloitte were happy with RBS’s approach as regards these procedures. But what about the content of the document? It is here that one has to study the

second of the above statements. What were the key performance data that Deloitte looked at? Sixteen different categories are listed. These range from the “number of mortgages provided to first-time buyers in 2011” to the “number of voluntary and compulsory redundancies”; the “employee diversity gender, age and ethnic profile” and the “number of project finance deals per Equator Principle category and industry sector”; “total community spend” and “total air travel”; and so on. They do not cover the data about the bank’s business model. How many of these headings should one regard as providing objective indicators of a bank’s sustainability? Can they be scored, with different values (as to sustainability relevance) being ascribed to each? For example, should a bank be regarded as scoring more “sustainability points” for an admirable record on, say, air travel than on first-time buyer mortgages? How are such judgements to be reached? There seems to be no attempt in the reports of either bank to distinguish core issues from the more peripheral issues.

The equivalent statement for the Barclays document is made by Ernst & Young LLP. This is laid out quite differently to the Deloitte statement, with the “meat” of the assurances taking the form of questions and answers. For example:

“Inclusivity

Has Barclays been engaging with stakeholders across the business to develop its approach to citizenship?

We are not aware of any key stakeholder groups that have been excluded from dialogue

We are not aware of any matters that would lead us to conclude that Barclays has not applied the inclusivity principle in developing its approach to citizenship”

“Completeness and accuracy

How plausible are the statements and claims within the Report?

We are not aware of any inconsistencies in the assertions made with regard to performance and achievement”

Such statements do not exactly fill one with confidence. How much simpler life would be for the reader if the reports clearly separated facts from opinion and the assurance statement just told us that the factual statements were accurate! No doubt, accountants have their reasons for the tortured style of English that they employ (not least, a fear of being sued) but perhaps a renewed appeal for the use of plain English and, as far as possible, the presentation of a self-contained statement with minimal cross-referencing may be made? To make the necessary investigations needed to support more assuring “assurances” would cost more money perhaps....but are we to take these reports seriously or not?

6. The documents of the two banks raise a range of issues and suggest there is room for improvement in (at least) the following areas:

Reducing the amount of material that relates to what the bank would have to do to comply with the law anyway or that is simply good customer relations (eg reducing queues in branches);

Presenting information that, as far as possible, enables verification and/or is accompanied by a statement from a third party that is confirmatory in nature.

Presenting information in a way that reflects a consensus (which, admittedly, may still need to be established) as to which are the more important issues and which are relatively peripheral;

Increasing the amount of material that is related to the bank’s own business model and culture and its sustainability;

Increasing the amount of material on the bank’s disciplinary record;

As far as possible, present material in a way that (i) makes comparison with previous years *and* with other banks easy (ii) distinguishes clearly fact from subjective commentary²⁸;

Improving the navigability of internet based documents so that, for example, (i) the indices of the Global Reporting Initiative are (where relevant) easily found (not the case, for example, with the RBS document) and (ii) one can easily follow a link to *any* cross-referenced item (either in the same document or elsewhere, such as the Annual Report) with appropriate page and paragraph references; and

Ensuring, as far as possible, that all banks present the same kind of information under the same headings (bearing in mind the widespread use of imprecise terminology such as “engagement”) and omit information and “PR material” that is not relevant to those headings.

In order to make progress in these areas, it is suggested that organisations that have an influential role in the content of sustainability reports (such as GRI or the “friends of paragraph 47”) take a fresh look at what the principal indicators of sustainability are *in the context of banks* and give more emphasis to issues that relate to a bank’s own business model, its culture and approach to ethical issues as opposed to the more “traditional” ESG issues. At present the focus at organisations like UNEP FI remains on how financial sector investment specialists could do a better, more “ESG-aware,” job if reporting on sustainability was better and more widespread. That is a worthy objective. But it should not be pursued to the exclusion of looking more closely at what sustainability means for the banks’ own business and for the financial system.

²⁸ According to the *FSSS of GRI*, “Comparability is necessary for evaluation performance. Stakeholders using the report should be able to compare information reported on economic, environmental, and social performance against the organisation’s past performance, its objectives, and, to the degree possible, against the performance of other organisations.” Clear and unambiguous language would seem to be an implicit requirement if this objective is to be met.

Through the lens of sustainability indicators, properly adapted for the peculiarities of banks, we could, if we wanted, start to learn a great deal more about bank behaviour and attitude than currently comes into the public domain. The sustainability reports, instead of being “just PR”, could become engines of change for the better. It seems inconceivable, after all, that a bank that had participated in something like the LIBOR rigging scandal could be considered a candidate for “Sustainable Bank of the Year”.

The use of “soft law” pressure, through the organisations mentioned in this article (and possibly others) is more likely to bring about change in an arena that looks both across jurisdictional boundaries and down to generations as yet unborn. Traditional law-making is ill-suited to dealing with the difficulties that the differing time and space dimensions present. But a greater level of consensus needs to be developed on what the objective indicators actually are of good and bad sustainable behaviour for a bank. Such indicators then need to be regularly updated rather than set in stone. The reporting requirements need to reflect that consensus. And banks should not feel free to pick and choose which ones they report on, entering “NR” if they find the matter too embarrassing or inconvenient. The reports should then be backed up by clear and unambiguous assessment statements from independent third parties. These would, as a result, carry some weight, rather than merely “perform a function of ritualistic comfort”²⁹ -- as now seems to be the case.

“Soft law” is not necessarily all that soft in its effect. The moral pressure that can be exerted by it can result, ultimately, in (to borrow from the Financial Times’ lead editorial of 29th June 2012, commenting on the LIBOR rigging scandal) “shaming the banks into better ways”. According to that editorial, the LIBOR rigging scandal shone an “unsparing light on the rotten heart of the financial system.” If we can get the senior officers of banks to understand that

²⁹ See CHIU “Standardization in Corporate Social Responsibility Statements” *Florida International Journal of Law* Vol. 22 No. 3 (December 2010) at 361 and 390.

society expects sustainability reports to provide both information on, and commitments relating to, a bank's culture, and that egregious incidents showing that such commitments have failed would generally be expected to lead to a resignation at the highest level, we can start to believe that some worthwhile change has at last been achieved. Making changes to reporting practices involves relatively small steps, and relatively easily achievable objectives. But small steps – if in the right direction – can have a big effect. If we can, through better reporting, insist that light is shone on what happens inside banks on a more regular basis and get out of the habit of taking bankers at their word when they tell us how good their “culture” is, we will start to make progress on meaningful reform. Such reforms would also have a positive effect on our collective efforts on the ESG agenda. To the extent that events like Rio+20 can look uncomfortably like “the West” lecturing the developing world whilst overlooking the catastrophes taking place in its own backyard, it would do no harm at all if the West (including the ESG community) took more positive steps to set its own house in order in relation to the sustainability of its banks and its financial system.³⁰ This must now be seen as a priority for all stakeholders, not just for governments and regulators.

³⁰ In an interview published on the *Times* on 2nd July, the President of the World Bank, Robert Zoellick, reflecting on Rio+20 – and the eurozone crisis – said, “The rest of the world is saying, who do these people think they are? We are worried they are going to bring down the world economy, and they are trying to tell us how to run our economies?”

INTERACTIONS BETWEEN EU AND NATIONAL AUTHORITIES IN THE NEW STRUCTURE OF EU FINANCIAL SYSTEM SUPERVISION

Vincenzo Troiano*

ABSTRACT: *The new institutional architecture for EU financial system supervision, also based on the establishment of the three sector European Supervisory Authorities, redesigns the role of national authorities, which are now expected to jointly co-determine regulatory choices at the EU level and, subsequently, ensure uniform application of such shared decisions at the national level. The paper examines how the interaction between the national and EU authorities operates, specifically focusing on ESAs' governance structure, both in terms of the governing bodies' composition and the rules of the decision-making process, also taking into account the participation of representatives of the different national authorities within the ESAs' governing bodies and their ability to jointly reach the decisions to be taken by ESAs.*

SUMMARY: 1. Introduction. – 2. The European System of Financial Supervisors: structure and functions. – 3. The ESAs: organization and governance. – 4. Relationships between the ESAs and the national authorities.

1. In 2010, a new institutional architecture for EU financial system supervision has been founded with a view to strengthening European supervisory construction which had been previously based on Level 3 Committees¹.

The EU Regulations which establish the three sector European Supervisory Authorities (ESAs)² indicate, *inter alia*, that such Authorities should aim at establishing high-quality common regulatory and supervisory standards and practices, by developing, *inter alia*, guidelines and recommendations as well as drafting regulatory and implementing technical standards³.

Some commentators tend to treat the changes that have followed in the aftermath of the crisis as a merely incremental continuum of the previous institutional scenario, thus downplaying the actual importance of such

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¹ For a general introduction, see WYMEERSCH, *The reforms of the European financial supervisory system - an overview*, in *European Company and Financial Law Review*, Volume 7, July 2010; MASCIANDARO, NIETO and QUINTYN, *Will They Sing the same Tune ? Measuring Convergence in the new European System of financial Supervisors*, 2009, IMF Working Paper WP/09/142; VAN MEERTEN and OTTOW, *The proposals for the European Supervisory Authorities: the right (legal) way forward ?*, available at: <http://ssrn.com/abstract=1517371>

² The above-referred EU Regulations are, respectively: Regulation (EU) no. 1093/2010 of 24 November 2010, whereby the European Banking Authority was established; Regulation (EU) no. 1095/2010 of 24 November 2010, whereby the European Securities and Markets Authority was established; Regulation (EU) no. 1094/2010 of 24 November 2010, whereby the European Insurance and Occupational Pensions Authority was established.

³ See MONTANARO and TONVERONACHI, *A critical assessment of the European approach to financial reforms*, in *PSL Quarterly Review*, vol. 64, n. 258 (2011), 193.

developments and insisting on the prominent role left to national regulators⁴. Others contend that the reform package can be regarded as a burgeoning watershed for financial regulation: the possibility that regulatory requirements may soon take the form of detailed technical rules would reduce the exercise of discretionary supervisory judgment at the national level⁵.

Looking towards the future, serious queries must be posed on how this model will evolve. From this standpoint as well, some commentators call for a decisive transfer of powers and responsibilities to the European level, especially with a view to addressing situations of financial distress faced by entities operating in different jurisdictions⁶. Others believe that the preferable route would be an Intervention-based Supervision as opposed to a Day-to-Day Supervision⁷.

The events occurred over the last several days further fuels these analyses *de iure condendo*⁸.

⁴ See KOST DE SEVRES and SASSO, *The New European Financial Markets Legal Framework: A real improvement ? An analysis of Financial Law and Governance in European Capital markets from a micro and macro economic perspective*, April 2011, available at <http://ssrn.com/abstract=1855636>.

⁵ See FERRAN, *Understanding the New Institutional Architecture of EU Financial Market Supervision*, in University of Cambridge, Faculty of Law, Legal Studies Research Paper Series, no. 29/2011, May 2011, available at <http://ssrn.com/abstract=1701147>, 45.

⁶ See FERRARINI and CHIODINI, *Nationally Fragmentated Supervision over Multinational Banks as a Source of Global Systemic Risk: a Critical Analysis of Recent EU Reforms*, September 2011, available at <http://ssrn.com/abstract=1923756>.

⁷ See SCHAMMO, *Eu Day-to Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision ?*, in *Oxford Journal of Legal Studies*, 2012, 1.

⁸ In the meeting held on 28 and 29 June 2012, the European Council passed certain decisions and guidelines aimed at preserving the single currency and terminate the vicious cycle between sovereign debt crisis and banks' predicament. In such context, a further goal consisted

Surely EU Regulations have parted from the dichotomy between the EU and national level, in favour of a structure whereby these two dimensions are intertwined to a significant extent; ESAs, together with the national Authorities, shall form part of a single European System of Financial Supervision (ESFS).

The scope of our analysis is to examine how the interaction between the national and EU levels operates, specifically focusing on ESAs' governance structure, both in terms of the governing bodies' composition and the rules of the decision-making process, also taking into account the participation of representatives of the different national authorities within the ESAs' governing bodies and their ability to jointly reach the decisions to be taken by ESAs.

The new model redesigns the involvement and participation of national authorities, which are now expected to jointly co-determine regulatory choices at the EU level and, subsequently, ensure uniform application of such shared decisions at the national level. This new structure will have an important two-fold impact: on the one hand, national authorities would be left with little room for discretion in the implementation phase, while, on the other hand, albeit fol-

in ensuring a unitary banking supervision system, considering also that the presence of intermediaries operating in different jurisdiction requires uniform rules and controls aimed at pursuing the stability of the European banking system in its entirety: see Euro Area Statement, available at <http://www.european-council.europa.eu/council-meetings.aspx>. The possible creation of a new banking supervisory mechanism run the by the European Central Bank - on the basis of Article 127(6) TFEU - is conceived as "a single, supportive and independent system, in which the decisions are adopted collectively and enforced at the appropriate level, being based on the experience and the professionalism of the national supervisory authorities": Visco, *Address of the Bank of Italy's Governor at the General meeting of the Italian Banking Association*, Rome, 11 July 2012, 4.

lowing a collective decision-making approach, the co-determination of decisions at the European level would broaden the reach of such authorities.

2. As it is well known, the three sector-specific Authorities, which are also united in the form of a joint committee, together with CERS and the individual national regulatory authorities comprise the new European System of Financial Supervisors (ESFS).

The new System has the primary task of ensuring that the financial sector rules are applied adequately, with the over-arching objectives of preserving financial stability, building trust in the financial system and ensuring sufficient protection for consumers of financial services. Such objectives are considered to be of equivalent importance yet they have been proposed in a precise order which certainly highlights the importance of systemic stability. On another front, the qualification of the objective of consumer protection (sufficient protection) somehow reflects a ranking of the priorities being pursued by the System.

As structured, the System constitutes a network of different entities⁹ that are linked, both horizontally among the Authorities carrying out supervision in

⁹ In general, on the aspects concerning the regulators' networks and the network governance in the context of regulatory sectors, see COEN and THATCHER, *Network Governance and Multi-level Delegation: European networks of Regulatory Agencies*, Jnl. Publ. Pol., 2008, 28, I, 49-59, underlining how the creation of European regulatory networks has determined "double delegation", i.e. "upwards" from the new independent agencies, and "downwards" from the European Commission. See also SCHAMMO, *supra* note 7, 8-16, sharing such approach with respect to sectorial authorities of the financial industry. As to new European financial regulation agencies, CHITI, *Le trasformazioni delle agenzie europee*, in *Riv. trim. dir. pubbl.*, 2010, 1, 69-70, observed that "the traditional type of agency, auxiliary to the Commission and structured so to create through its executive offices a plurality of relationships between the Commission and the

the different sectors, and vertically with regard to the nexus between such latter Authorities and the competent national authorities¹⁰. In this respect ESAs' tasks include assisting national regulatory authorities in the uniform interpretation and application of EU rules¹¹.

The integration, efficacy and, more generally, the successful outcome of the envisaged structure are based upon the principle of sincere co-operation between the entities involved, as highlighted in the EU Regulations. The EU Regulations specify that the parties to the ESFS must co-operate with full trust

national administrations, is being sided by a new type of agency, in which the administrative co-operation is carried out amongst National independent authorities and the same European body shall operate independently both from private entities and EU political institutions, including the Commission"; more specifically, Chiti pointed out that the new type of European agencies resembles to the "so called European regulatory concertation, in which two European regulators, a collegiate office composed of directors of national regulatory agencies or their representatives and characterized by certain independence features, and the Commission co-exist. European independent agencies represent an evolution of such instrument [...], since the European collegiate office is replaced by a more complex organization qualifying as a legal person and endowed with greater independence".

¹⁰ Pursuant to EU Regulations the ESAs shall organise and carry out verifications on the competent authorities on an *inter pares* basis (among equals), also by formulating guidelines and recommendations and identifying best practices, for the purpose of enhancing uniform regulatory supervision results. Such provisions identify a type of horizontal accountability, meant as reciprocal responsibility of the national authorities taking part to European agencies in contributing to the definition and application of the operating principles of the same agency.

¹¹ In such perspective, the EU Regulations are adopted also on the basis of Article 114 of TFEU, coherently with European case law according to which such rule would allow to regard as recipients of the provisions enacted thereunder also persons other than States; such interpretation would apply, in particular, whenever the European legislator deems advisable to create an *ad hoc* institution whose statutory scope is to contribute to the implementation of the harmonization process. Such interpretation would therefore apply with regard to ESAs, considering that the scope and tasks of ESAs are strictly related to the goals of the EU's *acquis* as to financial services domestic market (see recital 17 of the EBA Regulation).

and mutual respect, particularly with a view to ensuring the exchange of useful and reliable information.

Time will tell whether this structure will be sufficient and adequate to achieve the targeted goals¹².

3. The governance envisaged for the ESAs reflects the point of equilibrium reached between pressures driving the centralization of functions within the new entities and, in the opposite direction, demands seeking the maintenance on the part of national authorities of a guiding role in financial supervision. The adequacy and level of advancement of such equilibrium is subject to diverging interpretations. In general, there tends to be recognition that such equilibrium represented a good compromise, considering the limits set under the Treaty currently in force with respect to the various possible configurations¹³.

From an organizational standpoint, the Authorities envisage the presence of a Board of Supervisors and a Management Board.

3.1. As for the Board of Supervisors, the name itself evokes a clear reference to the derivation of the relevant members.

The Board, with regard to each of the three ESAs, is composed of (i) one representative per Member state of the competent national sector authority, and (ii) the Chairperson of the relevant Authority, a representative of the Com-

¹² And see also *supra* note 8.

¹³ See TARANTOLA, *La vigilanza europea: assetti, implicazioni, problemi aperti*, Rome, 8 April 2011, available at http://www.bancaditalia.it/interventi/intaltri_mdir/Tarantola_080411.pdf.

mission, a representative of the ECB, a representative of the CESR and one for each of the other two Authorities.

Consequently, the composition of the body in question is numerically open depending upon possible future changes in the number of member states. What is relevant is that the competent authority for each member state has an individual right to designate its own representative on the Board of Supervisors.

It is worth noting that *only* the representatives of the national authorities (all of them) have voting rights. The other members of the Board are only entitled to attend meetings, without entitlement to any voting rights¹⁴.

Each voting member may express one vote. The Board ordinarily passes resolutions by way of a simple majority of its members. On more important matters – such as, for example, the regulatory and implementing technical rules, the guidelines and recommendations and the powers of intervention – a qualified majority is necessary¹⁵.

The Board of Supervisors of the ESAs is in charge of taking all decisions and issuing all opinions on the matters for which they are responsible and exercise

¹⁴ The Executive Director of the Authority may attend the meetings of the Board of Supervisors, in this case as well without voting rights. The non-voting members and the observers, with the exception of the Chairperson and the Executive Director, shall not attend any discussions within the Board of Supervisors relating to individual financial institutions, save some specific exceptions (EU Regulations, 44.4).

¹⁵ In particular, the principle of the double majority as defined in art. 16, par. 4, TEU comes into play, on the basis of which starting from 1 November 2014, a qualified majority refers to at least 55% of the members of the Board, with a minimum of fifteen representatives of the member states amounting to at least 65% of the population of the European Union. See also the provisions of article 3 of protocol no. 36 (transitional provisions) to the EU Treaty, which govern the method of calculating qualified majorities until 1 November 2014 (using the system of weighted votes), and the possibilities of extending the same until 2017.

their powers, in accordance with the provisions set forth in chapter II of the EU Regulations¹⁶. On an annual basis, it approves, at the Management Board's proposal, the annual program of works.

In particular, the Board of Supervisors appoints six out of seven members (the seventh is the Authority's Chairperson) of the Management Board from among its voting members. It is expressly envisaged that the composition of the Management Board is balanced and proportionate, and that it reflects the whole European Union. Both the Chairperson and the Executive Director of the Authority are designated by the Board of Supervisors based upon their merits and expertise/capabilities, by way of an open selection procedure. In these areas, certain tasks and responsibilities are also assigned to the European Parliament which, with regard to the Chairperson, may challenge the relevant appointment after having heard the candidate selected by the Board of Supervisors up to one month after the selection thereof and, with regard to the Executive Director, must be consulted.

The Board of Supervisors may also exercise disciplinary powers against the Chairperson and the Executive Director, which extends to the possibility of deciding to revoke their mandates. It is worth noting, however, that the authority to revoke the Chairperson's mandate is on the European Parliament, upon a decision by the Board of Supervisors.

¹⁶ The Board of Supervisors adopts, at the proposal of the Management Board, the annual report on the Authority's activities, and sends the report, by 15 June of each year, to the European Parliament, the Court of Auditors and the European Economic and Social Committee and making it public.

3.2. The Management Board of each of the Authorities is comprised, in turn, of a Chairperson and six members who, as already noted, are appointed by and from among the voting members of the Board of Supervisors¹⁷.

The Management Board exercises powers in the areas of financial statement and personnel policies. It submits to the Board of Supervisors, for their approval, the annual report on the activities performed by the Authority and the annual and long-term programs of works. The Management Board passes resolutions and takes decisions with the majority of the votes expressed by the attending members, each of whom may express only one vote.

3.3. The Chairperson – a figure defined as an independent professional employed on a full-time basis – is in charge of representing the Authority¹⁸, and also preparing the works of the Board of Supervisors and presiding over meetings of such body and of the Management Board.

3.4. The organizational structure of the ESAs clarifies the important role that the overall plan has attributed to the members of the national competent authorities. These constitute the only voting members of the Board of Supervi-

¹⁷ Each member of the Management Body has an alternate, except for the Chairperson. The mandate of the members appointed by the Board of Supervisors is two and a half years, subject to one possible renewal.

¹⁸ The management of the Authority is entrusted to an Executive Director. He has the task of, *inter alia*, preparing the works of the Management Board, to execute the Authority's annual works program and prepare the long-term and annual works programs. He is also considered an independent professional hired on a full-time basis, appointed by the Board of Supervisors, upon confirmation by the European Parliament, based upon merits and expertise, through an open selection procedure.

sors, an entity in which the decision-making and organizational powers of the Authority are concentrated. The Board of Supervisors (i) is fully responsible for passing rulings and determinations which set forth the institutional and oversight activities assigned to the same; (ii) is in charge of appointing the members of the Management Board; (iii) has the power to revoke the mandates from these latter figures. The competent authority for each member state is entitled to take part in the Board of Supervisors with voting rights.

3.5. The importance conferred to national members in the above-described governance structure is further highlighted if we compare this system to a similar network-based system constructed at the EC level, the European system of central banks (ESCB).

Apart from the obvious differences of an institutional nature underlying the two systems¹⁹, it is worth considering the *governance* of ECB in comparison with that of the ESAs.

The ECB *governance* is structured around the Governing Council and Executive Board, which are the decision-making bodies of the entity.

The Governing Council is comprised of the members of the Executive Board and by the governors of the central banks (whose domestic currency is Euro). Even if, in principle, each member of the Council has one vote, this re-

¹⁹ See CHITI, *supra* note 9, 69, highlighting that the new type of European agencies distinguishes itself from the European central bank systems directed by the ECB as to, among others, independence matters, considering that, as to such aspects, the EU Commission, being a body independent from national government yet tied to the political majority expressed by the European Parliament, is completely barred from exercising the functions entrusted with the ESCB.

mains true for the members of the Executive Board, while the governors, should the total number of members of the Governing Council exceeds 21, may exercise not more than 15 votes, on the basis of specific revolving mechanisms in the exercise of voting rights (Protocol, art. 10).

The Executive Board is comprised of a chairman, a deputy chairman, and other four members, appointed among persons of known expertise and professional experience in the monetary or banking sector, in mutual agreement, by the governments of the member states, at the level of heads of state or heads of government, on a recommendation from the Council, following consultation of the European Parliament and the Governing Council²⁰.

The Governing Council is in charge of determining guidelines and taking decisions necessary to ensure the fulfillment of the tasks and duties assigned to the ESCB, as well as the formulation of the EC's monetary policy, including decisions on intermediate monetary objectives and guidelines for their implementation.

The Executive Board, which is responsible for preparing the meetings of the Governing Council, implements monetary policy on the basis of the guidelines referred to above, giving the necessary instructions to national central banks.

In the model described above (i) national members (specifically, national central banks) together with the member of the Executive Board comprise the Governing Council, without, however, representing the sole members with vot-

²⁰ If a member of the Executive Board no longer meets the necessary conditions for exercising his functions or has committed a serious breach, he may be declared resigned by the European Court of Justice, at the request of the Governing Council or the Executive Board.

ing rights and without holding voting rights on an individual basis, since the mechanism of revolving votes applies; (ii) the Governing Council is only consulted in the process of appointing the Executive Board; (iii) the latter body has much more substantial powers than those assigned to the Management Boards of the ESAs.

4. Having clarified the foregoing as to the governance of the ESAs, as well as that the representatives of the competent national authorities hold an important role that is more incisive than that, for instance, assigned to the national central banks within the ECB, our analysis shall now consider the relevant implications in order to elaborate a forward-looking definition of the relationships between ESAs and the national authorities.

4.1. In this regard, it is worth noting that the Regulations establish a principle of independence on the part of the Chairperson, the voting members of the Board of Supervisors and those of the Management Board. Under this principle, the persons in question must operate with full independence and objectivity, in the *exclusive interest of the European Union as a whole*, without requesting or receiving instructions from institutions or bodies of the EU, the governments of the member states or other public or private entities.

From an institutional standpoint, reference to the exclusive interest of the Union as a whole implies that the presence of the representatives of the competent authorities of each member state within the Board of Supervisors is not technically meant to channel the national interests of countries into the body,

but rather to identify a forum within which points of sustainable equilibrium may be reached on the various areas of focus, in the interest of the Union.

What is defined under the Regulations is therefore a mechanism of egalitarian participation on the part of all of the entities involved from an institutional perspective in determining regulatory, interpretational, action-based and guidance-based solutions which are considered valid and favorable for the entire EU.

From this standpoint, the participation in the Board of Supervisors by all of the competent national authorities, each endowed with the same voting rights, appears to be aimed at ensuring the mutual sharing of decisions on policy or oversight, obviously made on the basis of majority voting mechanisms, which constitutes (or should constitute) a substantive pre-condition to the genuine and consistent uniform application at the national level of the measures adopted and defined at the European level.

From a substantive standpoint, the joint participation in decisions and the implicit assumption of responsibility for the implementation of the same reflect the external relevance of the governance mechanisms referred to above.

A different issue, which is not subject to analysis, concerns the nature and effectiveness of the enforcement techniques in the event of possible non-conforming conduct with respect to the model described above with regard to the phase of uniform implementation in the decisions and choices made by the ESAs²¹.

²¹ See FERRAN, *supra* note 5, 48-51, observing that, with specific reference to the enforcement process contemplated by article 17 of the EU Regulations, “*unanswered questions remains*

4.2. The foregoing considerations lead us to wonder how the establishment of the new ESAs may impact upon the modalities to be followed by national authorities in the exercise of their supervisory functions, without prejudice to the current general principle on the basis of which the oversight of intermediaries continues to rest with such national authorities.

As mentioned, national authorities are now expected to jointly concur in the definition of the regulatory choices at EU level, and to ensure a uniform application of such shared decisions in their home jurisdiction. As a consequence, while their discretion in the implementation phase will be reduced, their ability to co-determine the decision at a European level should increase.

The component of the supervisory function which focuses on the definition of rules and general guidelines for sector operators (*i.e.* regulation) is undergoing an on-going and gradual evolution.

From this standpoint, the measures aimed at promoting common regulatory and disciplinary implementation are particularly important. The need to ensure a uniform disciplinary and application-based framework constitutes a specific objective of the systemic structure under discussion.

The elaboration of draft technical regulatory rules and technical implementing rules constitutes the tool that will have the greatest impact, through which the ESAs will fulfill their task of taking part, respectively, in the definition

about the practical enforcement steps that an ESA could take if a financial market participant were to fail to comply with a decision addressed to it”, yet that such apparent gap in the framework shall not raise excessive concerns, considering that it is highly likely that “in the ordinary course of events, matters would be resolved before they have escalated to the point” in which ESA may pass a formal direct decision addressed to the financial market participant.

of common regulatory and oversight rules and practices and the uniform application of legally binding EU acts. These are both measures aimed at reducing uncertainty and discretion on EC regulatory matters, in order to achieve, through specifications, supplements, clarifications and additional developments, a uniform regulatory approach. The assignment of prerogatives for the definition of such rules to the Authorities is driven by the fact that such entities are endowed with highly specialized technical expertise.

Legal doctrine has broadly analyzed the essential elements of the above-mentioned prerogatives assigned to the ESAs: to operate only where a delegation of powers to the Commission exists and the circumstance that such draft technical regulatory rules and technical implementing rules qualify as draft regulation to be endorsed by the Commission, which takes responsibility for them and passes them as its own²².

Both technical regulatory rules and implementing rules are adopted by regulation or decision – and therefore become mandatory (art. 288 TFEU) – and published in the EU Official Gazette. The binding nature of the technical rules, as realized in the form of regulation or decision by the Commission, overcomes what was previously seen as a point of weakness in of the European system involving third level committees and, in other words, the non-binding nature of their determinations.

²² Such analysis has been carried out with particular regard to the limits permitted by European law to delegation of powers on the basis of the Meroni doctrine (case 9/56 Meroni vs High authority, 1957-8, ECR 133): see KULL, *Legal implications of the establishment of the European Securities and Markets Authority* August 2011, available at <http://ssrn.com/abstract=1948071>, 28-31; GRILLER and ORATOR, *Everything Under Control? The “Way Forward” for European Agencies in the Footsteps of the Meroni Doctrine*, in *European Law Review*, 2010, 3.

The scope of the prerogatives assigned to the ESAs of elaborating, in accordance with the above-mentioned modalities, binding technical rules is determined through EC legislative acts. It goes without saying that the expansion of such tasks may potentially grant to the ESAs the power to define, at the technical level, increasingly broad areas of the overall application of EC principles, with the desired aim of achieving a uniform legal framework and application of European rules.

Likewise, there would be a corresponding reduction in the “creative contribution that national supervisors can make” to the point of arriving at a re-modulation of the functions of the national authorities, which would have effects also in terms of the attractiveness of such institutions²³.

Alongside the objective of pursuing uniform oversight practices and consistent application modalities within the European Union, the ESAs have the power to issue guidelines and to formulate recommendations addressed to the competent national authorities or to financial institutions. In this case, we are dealing with a prerogative that derives directly from the Regulations and does not constitute a delegated power. The adoption of the measures in question may be preceded by public consultations and cost-benefit analyses. In such case, we are not dealing with binding instruments. The recipients of the same, however, must make every effort to comply, in accordance with the rule of “comply or explain”. In particular, the national authorities which do not comply or which do not intend to comply, must inform the Authority and provide an ex-

²³ See FERRAN, *supra* note 5, 45, stresses the risk that national supervisory activity may become more formalistic and mechanical and, as a result, less appealing to highly qualified and capable professionals.

planation of the underlying reasons. The latter Authority publishes the information received; it may decide to also include an indication of the explanations provided by the national authority.

The non-binding nature of the instruments in question and the mechanism of adaptation referred to above leave room for the possibility that adaptations may occur which do not comply with the ESAs' guidelines.

However, it is also to be noted that the mechanism of recommendations may contribute toward achieving quickly and efficiently the over-arching objective of harmonizing operating and regulatory oversight practices. As a national example, one should consider, for instance, the decision by the Italian banking authority to consider immediately applicable for interpretational purposes related to the proper application of the provisions on corporate governance the contents of the Guidelines issued by the EBA in September 2011 on the matter of Internal Governance²⁴.

4.3. From a different standpoint, the current institutional structure (and the above-mentioned mechanism for participation on the part of the competent national Authorities within the Board of Supervisors of the three ESAs) calls for an analysis of the ways and forms in which the position of the various representatives will be developed within such forum. The foregoing must take place within the limits of compatibility with the indications set forth in the Regulations, on the basis of which the representatives of the national authorities must

²⁴ See BANK OF ITALY, *Applicazione delle disposizioni di vigilanza in materia di organizzazione e governo societario delle banche*, Rome, 11 January 2012.

pursue the interest of the European Union as a whole and not the respective national positions.

What is certain is that the development of the positions of the national Authorities will benefit from the review and analysis activities performed by the internal administrative structures called upon to assess from a technical standpoint the various proposals and measures to be later brought to the attention of the Board of Supervisors, also taking into account the specific modalities of interaction which may develop effectively between the ESAs and the individual competent national authorities.

Looking forward, it is reasonable to imagine that, at national level, more or less formalized modalities for interaction between the various competent national authorities and the industry will be structured. These modalities of interaction, presumably to be realized at the very beginning of the regulatory process, will be aimed not so much at channeling domestic requests but rather at better defining the position of the national authority within the Board of Supervisors, bolstering from a technical standpoint and on the basis of analysis of market implications, the positions to be brought within the European bodies.

REFORMS TO JAPANESE INSOLVENCY LAW

PROCEDURAL BACKGROUND AND MAIN POINTS

Masaki Sakuramoto*

ABSTRACT: *Starting out from the overview of the current regime of Japanese insolvency laws, this paper sets out to examine the principal reforms and normative changes which have been made to corporate and bankruptcy rules. Recently, legislative measures have been designed to establish a new system of ‘liquidation-type proceedings’ and ‘reorganization-type proceedings’. Liquidation-type proceedings are now divided into bankruptcy proceeding and special liquidation, while reorganization-type proceedings are now based into civil rehabilitation proceeding and corporate reorganization. These measures introduced substantive changes to the entire Bankruptcy Act, Civil Rehabilitation Act and Corporate Reorganization Act. In particular, these reforms show a full-scale review of the insolvency law regime and efficiently address the important question of reorganization-type insolvency proceedings for small or medium-sized enterprise. As a result, a closer examination of the new rules suggests that this brings to light a manifest normative development in Japanese financial regulation.*

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In Japan, the Imperial Era system of numbering years uses a different basis than that of the Western calendar. Under the Imperial Era system, counting begins with the succession of an each new emperor. For the reader’s convenience, we have provided both the Imperial Era (in parentheses, in italics) and Western calendar years in this article.

SUMMARY: 1. Introduction - 2. Procedural background to the reforms - 3. Main points of the reforms - A. Liquidation proceedings - 1. Bankruptcy - 2. Special Liquidation - B. Reorganization proceedings - 1. Civil Rehabilitation - (i) Ordinary Civil Rehabilitation - (ii) Individual Rehabilitation - 2. Corporate Reorganization - 3. Conclusion.

1. The established proceedings under the current regime of Japanese insolvency laws consist of bankruptcy, civil rehabilitation, corporate reorganization, and special liquidation. The bankruptcy is governed by the Bankruptcy Act, promulgated on June 2, 2004 (*16 Heisei*) as Act No. 75, which entered into force on January 1, 2005 (*17 Heisei*). The civil rehabilitation is governed by the Civil Rehabilitation Act, promulgated on December 22, 1999 (*11 Heisei*) as Act No. 225, which entered into force on April 1, 2000 (*12 Heisei*). The corporate reorganization is governed by the Corporate Reorganization Act, promulgated on December 13, 2002 (*14 Heisei*) as Act No. 154, which entered into force on January 1, 2003 (*15 Heisei*). The special liquidation is governed by the Companies Act, promulgated on July 26, 2005 (*17 Heisei*) as Act No. 86, which entered into force on May 1, 2006 (*18 Heisei*).

With this series of reforms in insolvency law, the composition (the Composition Act) and the corporate arrangement (the Commercial Code) were abolished.

2. Japan's preexisting insolvency law regime was established through the creation and enactment of the former Bankruptcy Act and Composition Act, en-

acted in 1922 (*11 Taisho*); corporate arrangement and special liquidation, created through the revision of the Commercial Code in 1938 (*13 Showa*); and the Corporate Reorganization Act, enacted in 1952 (*27 Showa*). However, the lack of substantive review over a long period, with the exception of partial revisions to the Bankruptcy Act in 1952 (*27 Showa*) and Corporate Reorganization Act in 1967 (*42 Showa*), coupled with developments such as changed circumstances from the periods in which each of these laws were enacted, led to a clamoring for the necessity of a full-scale review that would consider the entirety of insolvency law¹.

Furthermore, following the collapse of the so-called bubble economy, a deep and prolonged recession greatly influenced the area of insolvency. In the realm of personal insolvency, terms such as “card bankruptcy” and “credit bankruptcy” became emblematic of the precipitous rise in consumer insolvency caused by multiple debts. In the realm of corporation insolvency, large-scale corporate insolvencies of a sort and scope contemplated never before caused

¹ For the explanation of this part II, I relied heavily on the inquiry commission news (<http://www.moj.go.jp/SHINGI/>) available at the Ministry of Justice website and meeting logs of the Legislative Council of the Ministry of Justice (general body meetings), the committee on Insolvency Law, and the subcommittees, which were downloadable from the same website. I relied also on the following books; TAKUYA MIYAMA et al., *QUESTIONS AND ANSWERS ON THE CIVIL REHABILITATION ACT*, 2000 (12 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会); MASAMITSU SHISEKI, *QUESTIONS AND ANSWERS ON INDIVIDUAL REHABILITATION PROCEEDING*, 2001 (13 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会); TAKUYA MIYAMA ed., *QUESTIONS AND ANSWERS ON THE CORPORATE REORGANIZATION ACT*, 2003 (15 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会); HIDEKI OGAWA ed., *QUESTIONS AND ANSWERS ON THE NEW BANKRUPTCY ACT*, 2004 (16 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会) OSAMU HAGIMOTO ed., *COMMENTATED ARTICLE BY ARTICLE NEW SPECIAL LIQUIDATION PROCEEDING*, 2006 (18 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会).

even more complicated problems and revealed systemic inadequacies. Consequently, there was demand for a new legislation that would cope with these newly developed issues.

It was under these circumstances that, on October 8, 1996 (*18 Heisei*), a general meeting of the Legislative Council of the Ministry of Justice convened. And the Minister of Justice stated, “...in light of the need for reforms centered on laws such as the Bankruptcy, Composition, and Corporate Reorganization Acts, I would like to be presented with outlines to this effect”. On this occasion, a comprehensive inquiry was initiated into the entirety of insolvency law. The Legislative Council of the Ministry of Justice, having received these orders, formed a Committee on Insolvency Law, which held its first meeting² on October 24, 1996 (*8 Heisei*), and established the general goal of conducting its review within a five-year period. In December 1997 (*9 Heisei*), the committee issued³

² After this, the Legislative Council of the Ministry of Justice’s Committee on Insolvency Law lasted until the 144th meeting of the Ministry of Justice (as the general body meeting) on February 9, 2005 (*17 Heisei*), but substantive deliberations were conducted until the 40th meeting of the Legislative Council of the Ministry of Justice’s Committee on Insolvency Law on November 26, 2004 (*16 Heisei*). On January 6, 2001 (*13 Heisei*), the entire system of the Legislative Council of the Ministry of Justice was set to be renewed by its own order. Accordingly, in the 25th meeting of the Legislative Council of the Ministry of Justice’s Committee on Insolvency Law, occurring on July 28, 2000, the preexisting insolvency law committee established in October of 1996 (*8 Heisei*) was legally dissolved. Subsequently, a new committee on insolvency law was established and took over in its first meeting conducted on January 26, 2001. See minutes of the first meeting of the Legislative Council of the Ministry of Justice’s Committee on Insolvency Law on January 26, 2001(*13 Heisei*), <http://www.moj.go.jp/SHINGI/index.html>.

³ This was made public dated on December 9, 1998 (*10 Heisei*) under the name of the Ministry of Justice, Civil Affairs Bureau Counselor. It was published by the Publisher, Shouji Houmu Kenkyukai(商事法務研究会), titled “*Discussion Topics Regarding the Insolvency Law*” with items

the “Items for Consideration in Insolvency Law,” which compiled the issues that the group believed should be considered in its review and solicited opinions from concerned sectors⁴.

On April 23, 1998 (10 Heisei), the Liberal Democratic Party compiled “Land Claims Fluidization Total Plan”. One item of this Plan proposed some initial fixes to insolvency law. These fixes included new reorganization-type proceedings that mapped out reorganizations for insolvent enterprises, introduction of personal debtor rehabilitation proceedings that detail economic reorganizations for individual debtors, and fixes to provisions dealing with international insolvency cases. Additionally, the plan presented a schedule of revisions to related laws and stated that those revisions should be submitted to the Diet within the 2000 (12 Heisei) session. On the following day, April 24, the Comprehensive Economic Plan was announced, which was compiled in a cabinet meeting on economic policy. In this plan as well changes were proposed that aimed at providing a complete fix of legal insolvency proceedings, which would fairly and impartially adjust the rights among the interested parties with respect to bankrupt’s assets under the court’s participation. It also mandated a conclusion of the ongoing review at the earliest. Because mapping out an early fix of insolvency law was a pressing matter for the government and ruling party, the necessity of submit-

for discussion about insolvency law and related supplemental explanations (Supplement NBL No.46, 1998 (10 Heisei) Shouji Houmu Kenkyukai (商事法務研究会)).

⁴ The solicitation of opinions had a total of 237 organizations as its subjects, centering on courts, attorney groups, all universities which have the faculty of law or economics, professional legal associations, consumer groups, the economic sphere, and the labor world. See minutes of the 5th meeting of the Legislative Council of the Ministry of Justice’s Committee on Insolvency Law, July 24, 1998 (10 Heisei), <http://www.moj.go.jp/SHINGI/980724-1.html>.

ting a relevant law to the Diet within the 2000 (*12 Heisei*) session became externally apparent. On the basis of the results of the aforementioned solicitation of opinions from concerned sectors, in July 1998 (*10 Heisei*), the Committee on Insolvency Law within the Legislative Council of the Ministry of Justice reopened deliberations and, adhering to the new government plan, reduced the term of its review to one year. Within the committee, a First Subcommittee was established to discuss personal insolvency proceedings, international insolvencies, and other substantive insolvency law and a Second Subcommittee to discuss corporate insolvency proceedings. The subcommittees met alternately roughly every two weeks and open meetings for the entire committee convened once every three to four months.

Nevertheless on September 11 of the same year, the Minister of Justice issued reorganized proceedings to avert the bankruptcy of personal debtors, beginning with those becoming bankrupt from home loans, and a fix of reorganization-type insolvency proceedings for small or medium-sized enterprise. Both the issues had become extremely important owing to the economic conditions at the time. The need for further acceleration regarding these legislative efforts—especially the new fix for reorganization-type insolvency proceedings for small or medium-sized enterprise—provided a direction to submit a bill to revise the contents of insolvency law within the next legislative session in 1999 (*11 Heisei*). The legislative docket was revisited, with the reorganization-type insolvency proceedings being sectioned off from other discussion points to concentrate on it as top priority. Having abandoned the initial full-scale review

of the entire insolvency law regime, debates about the topic began in the order demanded by the urgency for legislative revision.

On July 23, 1999 (11 Heisei), at its 15th meeting of the Legislative Council, the Ministry of Justice's Committee on Insolvency Law unanimously approved a draft report of the "Guidelines for Civil Rehabilitation Proceedings (provisional title)."⁵ The Legislative Council of the Ministry of Justice later adopted it in its draft form by unanimous agreement at its 127th meeting (general body meeting) convened on August 26, 1999 (11 Heisei). The guidelines were presented to the Minister of Justice, who then submitted them to the 146th Diet on November 8, 1999 (11 Heisei), with the following justification⁶: *In view of the circumstances that demand a fairer and more expeditious handling of insolvency cases alongside the transformation and development of socioeconomic framework, we must rationally and efficiently plan for a rehabilitation of industry and economic activity vis-à-vis debtors who find themselves in economic predicaments. To that end, in place of the Composition Act, we are completing a system to preserve debtor assets prior to the initiation of rehabilitation proceedings. Furthermore, there is a need for basic legislation that newly establishes reorganization-type insolvency proceedings focusing on matters such as relaxing grounds for commencement of this proceedings, and establishing simple and logical investigation and determination of claims procedures while modifying the process for setting up rehabilitation plans and creating a means of ensuring the performance of those plans.*

⁵ For more information about the guidelines, see NBL No.670, p. 70 et seq. 1999 (11 Heisei).

⁶ As regards Reason for submission, retrieved from <http://www.moj.go.jp/HOUAN/SAISEIHO/refer03.html>.

This draft was enacted⁷ under the title of “The Civil Rehabilitation Act” on December 14 that year. It was promulgated⁸ on December 22 and went into effect on April 1, 2000 (12 Heisei). In addition, the Composition Act was repealed⁹ on March 31, 2000 (12 Heisei) with the implementation of the Civil Rehabilitation Act.

Subsequent to the civil rehabilitation proceedings, the committee set about creating a system for personal debtor rehabilitation proceedings—an area in urgent need of action—and conducted a thorough deliberation. As a result, on July 28, 2000 (12 Heisei), at the 25th meeting of its Legislative Council, the Ministry of Justice’s Committee on Insolvency Law unanimously approved the “Guidelines on Civil Rehabilitation Proceedings for Individual Debtors”¹⁰ as a draft report. The Legislative Council of the Ministry of Justice later adopted these guidelines in their draft form by unanimous agreement at its 130th meeting (general body meeting), convened on September 8, 2000 (12 Heisei). The guidelines were presented to the Minister of Justice, who then submitted them to the 150th Diet on October 13, 2000 (12 Heisei), with the following justifica-

⁷ The process of deliberations in the Diet was as follows: submitted to the Lower House Committee on Judicial Affairs on November 17, 1999 (11 Heisei), approved by the same committee on December 3 of the same year, passed in the Lower House on December 7 of the same year, submitted to the House of Councilors Committee on Judicial Affairs on December 8 of the same year, approved by the same committee on December 13 of the same year, and passed in the House of Councilors on December 14 of the same year.

⁸ The official gazette on the day of promulgation, titled the “*Outline of the Act*”, contains a simple explanation of the *Civil Rehabilitation Act* (December 12, 1999 (11 Heisei) *Official Gazette* Special Issue No. 252, p. 4).

⁹ See the Article 2 of the *Civil Rehabilitation Act Supplementary Provisions*.

¹⁰ For more information about the guidelines, see *NBL* No.688, p. 88 et seq. 2000 (12 Heisei).

tion¹¹: *In view of the increase in cases of personal insolvency and the internationalization of business insolvencies that have come with internal and external changes in circumstances of the social economy, it is necessary to establish special provisions for rehabilitation proceedings that swiftly and rationally reinvigorate the economic activity of individual debtors who find themselves in dire financial straits, being burdened with home loans and other debts, and to take measures that extend the effect of bankruptcy and reorganization proceedings initiated in Japan to foreign assets of the debtors.*

This draft was enacted¹² as “*the Partial Amendment to the Civil Rehabilitation Act and the like*” on November 21 of that year. It was promulgated¹³ on November 29 of the same year and went into effect on April 1, 2001 (13 Heisei). And in addition, the Act on Recognition of and Assistance for Foreign Insolvency Proceedings was also concurrently considered and entered into force by the same Diet.

¹¹ As regards reason for submission, retrieved from <http://www.moj.go.jp/HOUAN/MINJISASEI/refer03.html>

¹² The process of deliberations in the Diet was as follows: submitted to the House of Councilors Committee on Judicial Affairs on October 31, 2000 (12 Heisei), approved by the same committee on November 7 of the same year, passed in the House of Councilors on November 8 of the same year, submitted to the Lower House Committee on Judicial Affairs on November 14 of the same year, approved by the same committee on November 17 of the same year, passed in the Lower House on November 21 of the same year.

¹³ The official gazette on the day of promulgation, titled the “*Outline of the Act*”, contains a simple explanation of the *Partial Amendment to the Civil Rehabilitation Act and the like* (November 29, 2000 (12 Heisei) *Official Gazette Special Issue* No. 243, p. 2).

As concerns the Corporate Reorganization Act, at the 2nd meeting¹⁴ of its Legislative Council, on March 23, 2001 (13 Heisei), the Ministry of Justice's Committee on Insolvency Law conducted concurrent discussions about the Corporate Reorganization Act and sections of the Bankruptcy Act and Commercial Code dealing with such issues as corporate arrangements and special liquidations. The committee deliberated the Corporate Reorganization Act while the Subcommittee on Bankruptcy Law deliberated the Bankruptcy Act as well as other laws. At the 11th meeting¹⁵ of its Legislative Council on February 22, 2002 (14 Heisei), the committee composed a draft plan of the Guidelines for Revision of the Corporate Reorganization Act and the related supplementary explanations¹⁶. For one month beginning on March 1 of the same year, the Act was uploaded to the Ministry of Justice website and open to public comment. Deliberations centered on the public commentary continued thereafter, and at the 15th meeting of its Legislative Council, on July 26, 2002 (14 Heisei), the Ministry of Justice's Committee on Insolvency Law decided upon a draft report titled "Guidelines for Revision of the Corporate Reorganization Act"¹⁷. The Legislative Council of the Ministry of Justice adopted this in its draft form by unanimous

¹⁴ Minutes of the 2nd meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law: <http://www.moj.go.jp/SHINGI/010323-1.html>

¹⁵ Minutes of the 11th meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law: <http://www.moj.go.jp/SHINGI/020222-1.html>

¹⁶ Appears in the Business Rehabilitation Research Institute's Symposium on Reform of the Corporate Reorganization Act (Supplement NBL No.70, p. 86 et seq. 2002 (14 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会) as "Draft of Corporate Reorganization Act Reform Guidelines" and "Supplemental Explanation of Draft of Corporate Reorganization Act Reform Guidelines".

¹⁷ See *supra* note 17, Supplement NBL No.70., at 70 et seq.

agreement at its 137th meeting (general body meeting) convened on September 3, 2002 (14 Heisei). The guidelines were presented to the Minister of Justice, who then submitted it to the 155th Diet on October 21, 2002 (14 Heisei), with the following justification¹⁸: *In view of circumstances such as those that demand a smoother and more expeditious handling of the business insolvencies that have come with the transformations of the social economy, we must rationally and effectively devise a reorganization scheme that preserves the operations of those corporations facing financial troubles. To that end, it will be necessary to enact measures that perform such functions as relaxing territorial jurisdiction rules pertaining to reorganizations that preserve the assets of reorganizing companies prior to the initiation of the reorganization proceedings, relaxing grounds for commencement of this proceedings, making the procedures that follow commencement of such proceedings simple and rational, mandating submission of an early-stage reorganization plan, and relaxing the conditions for approval of such a plan while revamping the method of reorganization.*

This draft was enacted¹⁹ as the total revision²⁰ of the Corporate Reorganization Act on December 6, 2002 (14 Heisei). It was promulgated²¹ on December 13 of the same year and went into effect on April 1, 2003 (15 Heisei).

¹⁸ As regards reason for submission, retrieved from <http://www.moj.go.jp/HOUAN/KOUSEI/refer03.html>

¹⁹ The process of deliberations in the Diet was as follows: submitted to the Lower House Committee on Judicial Affairs on November 12, 2002 (14 Heisei), approved by the same committee on November 26 of the same year, passed in the Lower House on November 28 of the same year, submitted to the House of Councilors Committee on Judicial Affairs on the same day, approved by the same committee on December 5 of the same year, and passed in the House of Councilors on December 6 of the same year.

As concerns the Bankruptcy act, the separately established Bankruptcy Law Subcommittee discussed substantive insolvency law and bankruptcy proceedings for corporations and individuals concurrently with discussion about revision of the Corporate Reorganization Act. These discussions continued until August 9, 2002 (14 Heisei), spanning 15 rounds of meetings. Thereafter, on September 13, 2002 (14 Heisei), the scene shifted to the Committee on Insolvency Law, where deliberations continued. In its 17th meeting²² on September 27 of that year, the Legislative Council of the Ministry of Justice's Committee on Insolvency Law decided to prepare an interim draft plan and supplemental explanations²³ concerning review of the Bankruptcy Act and other laws, which were then open to public comment. Deliberations centering on the public commentary continued, and on July 25, 2003(15 Heisei), at the 34th meeting of its Legislative Council, the Ministry of Justice's Committee on Insolvency Law decided upon a draft report titled "Guidelines on Review of the Bankruptcy Act and Other Law." The Legislative Council of the Ministry of Justice adopted this in

²⁰ This was only a complete reform, not a new legislation, because the framework for the structure of proceedings of the *Pre-Corporate Reorganization Act* was not changed (December 13, 2002 (14 Heisei) *Official Gazette Special Issue* No. 269, p. 41.).

²¹ The official gazette on the day of promulgation, titled the "*Outline of the Act*," contains a simple explanation of the Corporate Reorganization Act (December 13, 2002 (14 Heisei) *Official Gazette Special Issue* No. 269, p. 5).

²² Minutes of the 17th meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law: <http://www.moj.go.jp/SHINGI/020927-1.html>.

²³ This interim draft on the review of the Bankruptcy Act is published alongside that on the supplemental explanations for the review of the *Bankruptcy Act* as "*Interim Draft and Commentary Pertaining to Review of the Bankruptcy Act and the like*" (*Supplement NBL* No.74 2002 (14 Heisei) *Shouji Houmu Kenkyuukai* (商事法務研究会)).

its draft form by majority vote (11 in favor, 2 opposed)²⁴ at its 141st meeting (general body meeting) convened on September 10, 2003 (15 Heisei). It was presented to the Minister of Justice, who then submitted it to the 159th Diet on February 13, 2004 (16 Heisei), with the following justification²⁵: *In view of the precipitous rise in bankruptcy cases accompanying the transformation of our socioeconomic conditions, we must plan for the expediting and rationalizing of bankruptcy proceedings while also ensuring efficacy and fairness.*²⁶ *To this end, it will be necessary to enact measures that make simpler and more rational procedures such as those for the investigation and determination of claims as well as for liquidating distributions, enlarge those courts with jurisdiction, expand the system of protections for debtor's assets prior to the initiation of bankruptcy proceedings, review the priority of each type of claim relating to bankruptcy, expansion of the scope of properties not within the bankruptcy estate, and reform the system of the right of avoidance.* This draft was enacted as the new legislated²⁷ Bankruptcy Act on May 25, 2004 (16 Heisei). It was promulgated²⁸ on June 2

²⁴ A statement of the opposing rationale says: "Labor claims are not being prioritized... and that's a big problem": <http://www.moj.go.jp/SHINGI/030910-6.html>.

²⁵ As regards reason for submission, retrieved from <http://www.moj.go.jp/HOUAN/HASAN/refer03.html>.

²⁶ The process of deliberations in the Diet was as follows: submitted to the House of Councilors Committee on Judicial Affairs on March 30, 2004 (16 Heisei), approved by the same Committee on April 6 of the same year, passed in the House of Councilors on April 7 of the same year, submitted to the Lower House Committee on Judicial Affairs on May 13 of the same year, approved by the same committee on May 21 of the same year, and passed in the Lower House on May 25 of the same year.

²⁷ The *Pre-Bankruptcy Act* (Law No. 71, 1922 (11 Taisho)) is repealed in Article 2 of the *Bankruptcy Act Supplementary Provisions*.

of the same year and went into effect on January 1, 2005 (*17 Heisei*). Because it became necessary to modify existing provisions in the Civil Rehabilitation Act, Corporate Reorganization Act, and other laws related to insolvency proceedings alongside the Civil Code and related laws, the Legislation on the Amendment of Related Law Occasioned by the Implementation of the Bankruptcy Act was concurrently approved and established.

Once the deliberations on the Bankruptcy Act concluded, most of the pressing issues in the full-scale review of the insolvency law regime had been addressed. However, corporate arrangements and special liquidations provided for in the Commercial Code were lingering points of discussion in insolvency law. Therefore, the Legislative Council of the Ministry of Justice's Committee on Insolvency Law began discussions thereupon in its 35th meeting, beginning December 12, 2003 (*15 Heisei*). At this meeting, a Special Liquidation Subcommittee was appointed. This subcommittee decided that its discussions would be tied to the debate in the Committee on Insolvency Law and reaffirmed²⁹ directions to draft a proposal within the type of time frame similar to that for the modernization of the Commercial Code. The subcommittee convened four times between February 20 and May 21, 2004 (*16 Heisei*). Subsequently, on June 18, 2004 (*16 Heisei*), the scene shifted to the Committee

²⁸ The official gazette on the day of promulgation, titled the "*Outline of the Act*", contains a simple explanation of the *Bankruptcy Act* (June 2, 2004 (*16 Heisei*)) Official Gazette Special Issue No. 115, p. 7).

²⁹ Minutes of the 35th meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law: <http://www.moj.go.jp/SHINGI/031212-1.html>.

on Insolvency Law, where deliberations continued. In its 37th meeting³⁰ held on July 16 of that year, the Legislative Council of the Ministry of Justice's Committee on Insolvency Law decided upon its draft guidelines and their supplemental explanations³¹ concerning the review of Special Liquidation and the like, which was then made open for public comment. Deliberations centering on the public commentary continued thereafter, and at the 40th meeting of its Legislative Council, held on November 26, 2004 (16 Heisei), the Ministry of Justice's Committee on Insolvency Law approved a draft report titled "Guidelines on Review of Special Liquidation and the like."³² The Legislative Council of the Ministry of Justice adopted this in its draft form by unanimous agreement at its 144th meeting (general body meeting), convened on February 9, 2005 (17 Heisei). The Guidelines were then presented to the Minister of Justice. The revision of special liquidation and corporate arrangement was conducted as part of an exhaustive, full-scale review of the insolvency law regime. While corporate arrangement was abolished, the special liquidations contained in the framework of the existing Commercial Code were incorporated into the guidelines on modernization of Companies Act. These guidelines were then submitted to the 162nd Diet on March 22, 2005 (17 Heisei), as Chapter Ⅸ, Section 2 (Special Liq-

³⁰ Minutes of the 37th meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law: <http://www.moj.go.jp/SHINGI/040716-1.html>.

³¹ For more on the draft guidelines, see <http://www.moj.go.jp/PUBLIC/MINJI48/refer01.html>; Minji Geppout (民事月報) Vol. 59 No. 9, p. 41 et seq. 2004 (16 Heisei); NBL No.790, p. 73 et seq. 2004 (16 Heisei); Kin'yuu Houmu Jijout (金融法務事情), No. 1715, p. 55 et seq. 2004 (16 Heisei). For the supplemental explanations, see <http://www.moj.go.jp/PUBLIC/MINJI48/refer02.pdf>.

³² For more information about the guidelines, see Kin'yuu Houmu Jijout (金融法務事情), No. 1733, p. 81 et seq. 2005 (17 Heisei).

liquidation) of the Companies Act; were established³³ on June 29; promulgated³⁴ as the Companies Act on July 26 of the same year; and entered into effect on May 1, 2006 (*18 Heisei*).

3.(A) Liquidation-type proceedings are divided into 1 bankruptcy proceeding, which is based on the Bankruptcy Act, possess basic characteristics of liquidation law, and focus on both natural persons and corporations, and 2 special liquidation, which is based on the Companies Act, possess special characteristics of liquidation law, and focus solely on stock companies under liquidation.

1. The newly enacted version of the Bankruptcy Act, being the most important and central part of the full-scale review of the insolvency law had its purpose in the Article 1:” The purpose of this Act is, by specifying the proceedings for liquidation of property held by debtors who are unable to pay debts or insolvent, etc., to appropriately coordinate the interests of creditors and other interested persons and the relationships of rights between debtors and credi-

³³ The process of deliberations in the Diet was as follows: submitted to the Lower House Committee on Judicial Affairs on April 7, 2005 (*17 Heisei*), approved by the same Committee on May 17 of the same year, passed in the Lower House on the same day, submitted to the House of Councilors Committee on Judicial Affairs on May 18 of the same year, approved by the same committee on June 28 of the same year, and passed in the House of Councilors on June 29 of the same year.

³⁴ The official gazette on the day of promulgation, titled the “*Outline of the Act*”, contains a simple explanation of the *Companies Act* (July 26, 2005 (*17 Heisei*) *Official Gazette Special Issue* No. 168 (one of an eleven-part issue), p. 1.

tors, with the aim of ensuring proper and fair liquidation of debtors' property, etc. and securing the opportunity for rehabilitation of their economic life"³⁵.

The main points of this review of bankruptcy can be divided into four central issues³⁶: (1) review of the entire bankruptcy proceeding, (2) review of personal bankruptcy and discharge proceedings, (3) review of the substantive insolvency law, and (4) other miscellaneous issues.

The changes in regard to item (1) several objectives were established from the viewpoint to expedite and rationalize the proceedings, other objectives were established from the viewpoint to guarantee fairness of the expediting and rationalizing the proceedings. The former: (a) expansion of courts with jurisdiction, (b) simplification and rationalization of proceedings for the investigation and determination of bankruptcy claims, (c) making creditors' meeting voluntary and introduction of a new system of voting by document, (d) creation of a system to permit payment of labor claims, and (e) creation of a system for the extinguishment of security interests in private contract sales by bankruptcy trustee. The latter: (a) expansion of temporary restraining orders for the introduction of, inter alia, comprehensive prohibition and provisional administration orders, (b) reform of the processes for inspecting and replicating case-related documents, (c) creation of a system of creditors' committee, (d) creation of an obligation of disclosure of important property of the bankrupt, and (e) introduction of a system of officer's liability assessment orders for bankrupt companies.

³⁵ As regards Legislative goal, retrieved from <http://www.moj.go.jp/HOUAN/houan25.html>

³⁶ From "*Summary of the New Bankruptcy Act*" on the Ministry of Justice website (address same as supra note 36).

The changes in regard to item (2) were (a) expansion of the scope of properties not within the bankruptcy estate, (b) integration of bankruptcy and discharge proceedings, (c) prohibition of compulsory executions during discharge proceeding, (d) expansion of the scope of claims not within the discharge, and (e) creation of a bankrupt's obligation to cooperate in investigations pertinent to discharge proceeding, whether in court or otherwise.

The changes in regard to item (3) were (a) partial transformation of labor claims into estate claims, (b) partial transformation of claims for tax into bankruptcy claims, (c) strengthening of lessee protections in the event of a bankrupt lessor, and (d) modification of the system of the right of avoidance so as to reduce the risk of avoidance of acts of disposing of property conducted while receiving reasonable value in Article 161 of the Bankruptcy Act.

The changes in regard to item (4) were (a) review of bankruptcy crimes, (b) change in the arrangement of articles by logging of the proceedings and modernization of colloquial *hiragana* expressions, (c) placement of the definitions of the terms of art in Article 2 of the Bankruptcy Act, and (d) stipulation of the necessary matters concerning bankruptcy proceedings, etc. by the rules of the Supreme Court in Article 14 of the Bankruptcy Act³⁷.

2. Reforms were made to various points pertaining to special liquidation³⁸, including expansion of the jurisdiction of claims courts initiating special liquida-

³⁷ As regards items (a) and (b), see H. OGAWA ed., *supra* note 2, at 15-16.

³⁸ For more detail, see TETSU AIZAWA, *QUESTIONS AND ANSWERS ON THE NEW COMPANIES ACT*, p. 173 et seq., 2005 (17 Heisei) Shouji Houmu Kenkyuukai (商事法務研究会); Osamu

tion of a subsidiary company where insolvency proceedings involve the parent company, relaxation of agreement approval requirements, and establishment of a system for limiting review requests for case-related documents or obstructive parts of a review. However, while the subcommittee was working to ensure the merits of special liquidation, the logical handling of their interaction with bankruptcy proceedings proved troublesome in terms of whether all corporations should be able to universally take advantage of such special liquidation proceedings. Upon the realization of the inevitability of an expansive review of the place of bankruptcy proceedings in this question, the committee dismissed the issue until a later date³⁹.

The corporate arrangement proceeding was abolished with the reasoning that “the existential significance for a corporate restructuring process that functions as reorganization proceedings exclusively for stock companies has been lost after the implementation of the Civil Rehabilitation Act”⁴⁰.

3.(B) Reorganization-type proceedings are divided into 1 civil rehabilitation proceeding, which is based on the Civil Rehabilitation Act, possess basic characteristics of reorganization law, and focus on both natural persons and corporations, and 2 corporate reorganization, which is based on the Corporate

Hagimoto, *Summary of the New Special Liquidation Proceeding*, p. 7 et seq., No. 1750, Kin'yuu Houmu Jijout (金融法務事情) 2005 (17 Heisei).

³⁹ Minutes of the 36th meeting of the Legislative Council of the Ministry of Justice's Committee on Insolvency Law :<http://www.moj.go.jp/SHINGI/040618-1.html>.

⁴⁰ Minutes of the 144th meeting of the Legislative Council of the Ministry of Justice (general body meeting):<http://www.moj.go.jp/SHINGI/050209-5.html>.

Reorganization Act, possess special characteristics of reorganization law, and focus solely on stock companies.

1.(i) The Civil Rehabilitation Act is a new legislation that functions as easy-to-use reorganization-type insolvency proceeding for small or medium-sized enterprise, sole proprietorships, or non-stock company—legal entities that cannot utilize corporate reorganization proceeding. Before the passage of the Civil Rehabilitation Act, small or medium-sized enterprise, and the like would use composition proceeding found in the Composition Act. However, because nearly 80 years had passed since the enactment of the Composition Act, there were many problems and inadequacies. Many of these problems were at the root of the regime, and amending the Composition Act to conform to the modern economic structure was considered difficult. Therefore, to correct and overcome these problems, the Civil Rehabilitation Act was enacted⁴¹ in 1999 (*11 Heisei*) with the following legislative purpose: “In order to rationally and efficiently plan for a rehabilitation of business and economic activity of those debtors who find themselves in financial predicaments, we shall establish a new, basic law on reorganization-type insolvency proceeding that replaces the Composition Act”⁴².

An outline⁴³ of the Civil Rehabilitation Act can be generally split into three parts: (1) proceedings that provide a legal framework for entities such as small or medium-sized enterprise to easily reorganize, (2) fair and transparent pro-

⁴¹ See T. MIYAMA et al., *supra* note 2, at 7.

⁴² As regards Legislative goal, retrieved from <http://www.moj.go.jp/MINJI/minji19.html>.

⁴³ From “*Summary of the Civil Rehabilitation Act*” on the Ministry of Justice website (address same as *supra* note 41).

ceedings for interested persons such as creditors, and (3) expedient and efficient proceedings in conformity with a modern economy and society.

As features of outline, item (1) include (a) an ability to be utilized by all legal and natural persons, (b) allowance of claims to be brought prior to entering into substantial situation of bankruptcy, (c) availability of the so-called DIP (debtor-in-possession) proceeding, (d) fulfillment of temporary restraining orders prior to the commencement of proceeding, and (e) securing integration of insolvency cases such as concerning parent and subsidiary companies.

Item (2) accomplishes (a) an introduction of a system of avoidance that ensures fairness for debtors, (b) prevention of the moral hazards that arise from the investigation into the civil and criminal liability of officers, (c) ensuring performance of rehabilitation plans under the monitoring of supervisors, (d) strengthening of the procedural participation of creditors by introducing a new system of creditors committee, (e) protection of the creditors' interests by placing the transfer of business operations during the course of proceedings into the court's permission, and (f) ensuring transparency of proceedings by instituting review rules for case-related documents.

Item (3) accomplishes (a) making creditors' meeting voluntary and introduction of a new system of voting by document, (b) simplification and rationalization of the procedure for investigation and determination of claims, (c) creation of a system for the extinguishment of security interests to ensure the use of business assets, (d) clarification of priorities for settlements regarding reorganization assistance loans, etc., (e) creation of a system of the court's permission in place of shareholder meeting resolutions due to the transfer of

business operations or the reduction of the stated capital, (f) abridgment of part of the ordinary proceedings to establish special proceedings that aim for speedy creation of a rehabilitation plan, (g) introduction of a system for the prompt execution when there is delay in fulfillment and for the revocation of the rehabilitation plan, and (h) adjustment of rules that deal with international insolvency cases.

1.(ii) Even though there had been a spike in the number of personal debtors going through bankruptcies on account of home loans and other debts, ordinary civil rehabilitation proceeding, which are intended for a small or medium-sized enterprise operator, were difficult to apply to consumers, such as office workers, given their heavy procedural burdens. Accordingly, in December of 2000 (12 Heisei) the Civil Rehabilitation Act was partially amended⁴⁴ with the following legislative purpose: “We will put in place special procedural rules that expeditiously and rationally carry forward civil rehabilitation proceedings for debtors on the verge of bankruptcy through home loans and other debt”⁴⁵.

There are several central features⁴⁶ of this amendment, which are (1) rehabilitation proceeding for individuals with small-scale debts, (2) rehabilitation proceeding for salaried workers, etc., and (3) special provisions relating to home loans. Note that, while items (1) and (2) are limited to personal debtors, item (3)

⁴⁴ See M. SHISEKI, *supra* note 2, at 6.

⁴⁵ As regards Legislative goal, retrieved from <http://www.moj.go.jp/HOUAN/houan08.html>

⁴⁶ From “*Regarding the ‘Law Partially Amending the Civil Rehabilitation Act and Other Law’ Passed by the 150th Diet*” on the Ministry of Justice website (address same as *supra* note 46).

may be also utilized in ordinary civil rehabilitation proceeding in addition to proceedings initiated under (1) and (2).

Item (1) exists for individual debtors who are likely to continuously or regularly earn income in the future and the total amount of rehabilitation claims owed by him/her (excluding the amount of home loan claim(s), rehabilitation claim(s) for which payment is expected to be received by exercising a right of separate satisfaction, and claim(s) for fines, etc., arising prior to the commencement of rehabilitation proceedings) is not more than 50 million Yen (more or less 500,000 Euros, using the rate of 1 Euro to 100 Yen)⁴⁷. Then the debtor will follow the court-confirmed rehabilitation plan, making payments over 3-years on a fixed amount (this exceeds the amount of payment in cases of bankruptcy, and is higher than the lowest amount of payment which is fixed by this Act). As a result, there will be a process to discharge the remaining debt.

Under item (2), the debtor stated in item (1) above, those expecting to receive a salary or similar regular income, and those for whom such salaries or income are expected to fluctuate within a small range will follow a court-approved rehabilitation plan to pay at least 2 years' worth of disposable income (this exceeds the amount of payment in cases of bankruptcy and is higher than the lowest amount of payment which is fixed by this Act) generally within 3 years. As a result, there will be a process to discharge the remaining debt.

⁴⁷ Per Article 1 of the Law on Reforms of Related Law accompanying the Enforcement of the Bankruptcy Act, the total amount has been raised from 30 million Yen to 50 million Yen (in effect as of January 1, 2005 (17 Heisei)).

Item (3) recognizes, through measures such as extending the terms for payment on the loan, an economic rehabilitation that does not require a debtor carrying home loan debt to forfeit the residence.

2. Total revision of the Corporate Reorganization Act was accompanied by the following legislative purpose: “In order to make possible smoother and more efficient reorganization for large-scale companies in financial trouble, we must completely revise the former Corporate Reorganization Act enacted in 1952 (27 Showa), and we must modify corporate reorganization proceedings to make them effective and in conformity with a modern economy while aiming to expedite, strengthen, and rationalize them”⁴⁸.

There was no change in the basic proceeding of this regime such as (1) making claim at the commencement of the reorganization proceeding, (2) making decision to initiate the reorganization proceeding, (3) preparing, approving, and confirming the reorganization plan, (4) exercising the reorganization plan, and (5) order of the termination of the reorganization proceedings. However, with a view toward (a) expediting, (b) rationalizing, and (c) strengthening the proceeding, changes were made in many points.

The central issues⁴⁹ in review of corporate reorganization can be divided broadly, as noted above, into three categories: (a) expedition of the proceeding, (b) rationalization of the proceeding, and (c) strengthening of the proceeding.

⁴⁸ As regards Legislative goal, retrieved from <http://www.moj.go.jp/HOUAN/houan15.html>.

⁴⁹ From “Regarding ‘the New Corporate Reorganization Act’ Passed by the 155th Diet: Summary of the New Corporate Reorganization Act” on the Ministry of Justice website (address same as *supra* note 49).

The changes made with respect to item (1) were (i) easing of the necessary conditions for the initiation of the proceeding, (ii) mandating submission of a proposed reorganization plan within one year after the commencement of the proceedings, (iii) easing the conditions for the approval of such plans, and (iv) making a time frame for the conclusion of proceeding earlier.

The changes with respect to item (b) were (i) enabling submission of claims from all over Japan to the district courts in Tokyo and Osaka, (ii) adjusting provisions for the review and replication of case-related documentation to ensure transparency in the proceeding, (iii) restricting the timeframe for repayment pursuant to the reorganization plan to a maximum of 15 years, and (iv) introducing a new system of voting by document as a method for approving the proposed reorganization plans.

The changes made with respect to item (3) were (i) introducing temporary restraining order that uniformly prevent compulsory execution, that is to say comprehensive prohibition order, (ii) clarifying that directors and the like with no administrative responsibility of the concerned company may be nominated to trustee, (iii) introducing a new system for court permission of transfers of business prior to the approval of a reorganization plan, and (iv) creating a system for extinguishment of security interests that allows early sale of articles with security interests attached.

3. The project on a full-scale review of the insolvency law regime, which began in October 1996 (8 Heisei), required nearly 10 years to complete. This

project nearly reached their goals with the passage of the reformed Bankruptcy Act on May 25, 2004 (16 Heisei). However, this was actually concluded on June 29, 2005 (17 Heisei) with the passage of the Companies Act that included the revision of special liquidation.

Although the full-scale review of the insolvency law system that was anticipated prior to the actual review was not realized, the insolvency law regime that had been known till then as the “Five laws of insolvency” became the “Four laws of insolvency”, consisting of the bankruptcy proceedings based on the newly enacted Bankruptcy Act, the civil rehabilitation proceedings based on the newly enacted Civil Rehabilitation Act, the corporate reorganization proceedings based on the totally revised Corporate Reorganization Act, and the special liquidation proceedings based on the newly enacted Companies Act.

NEW MEANS OF ORGANIZATIONAL GOVERNANCE TO REDUCE THE EFFECTS OF EUROPEAN ECONOMIC CRISIS AND IMPROVE THE COMPETITIVENESS OF SMES

Vladimir Uskov and Nunzio Casalino*

ABSTRACT: *This article is aimed at researching an organizational concept of informal learning, which can be described figuratively as an iceberg: mostly invisible on surface and immense in its mostly submerged informal aspects. The main goals of this research are 1) to better understand and improve a recognition of non-formal and informal learning acquired through work experience in Small and Medium Enterprises (SMEs), and 2) to overcome, or, at least, reduce economic crisis' effects on European SMEs. Traditional models of on-job training are often not sufficient for continuous skills' update and upgrade as they are cumbersome and limit learners to prescribed and closed educational/training systems. There are many methods and a variety of techniques to collect evidence to provide a basis for judgments about whether learning/training outcomes (skills and competences) have been acquired or not. Learning and knowledge support systems have to transform professional knowledge to non-specialists. Current*

* Although the article is the result of joint observations of the two authors, the abstract and the paragraph 1 have to be attributed to Vladimir Uskov, while the paragraphs 2, 3, 4, 5, 6, 7 to Nunzio Casalino.

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contents and learning systems, enhanced by Web 2.0, provide a viable solution to fast-paced and multitask-oriented patterns of learning and working today. They enable learning in small steps and with small units of content through social interaction. Learning modules aligned with formal learning and embedded in online communities have a potential to support on-going professional development. As corporate learning departments seek various new ways and options to more efficient and effective cross-training of employees, informal learning has become an increasingly valuable alternative.

SUMMARY: 1. Introduction. - 2. Designing a recognition methodology. - 3. The research and the investigation method. - 4. Aspects that effect non-formal and informal learning in SMEs. - 5. Organizational issues and social media adoption to better manage European financial crisis effects. - 6. Remarks and advices for SMEs managers. - 7. Conclusions.

1. Informal learning and/or training (further: *informal learning*) can be defined as a learning process which occurs at the workplace and is neither organised nor designed by an organization¹. This definition helps to distinguish between goals of the learning and a process of learning. It also emphasizes that an organization should be involved into an informal learning and facilitate an occurrence of learning without making it formal.

In general, an informal learning emerges from specific worker's needs. For SMEs, an effectiveness of a learning event is determined by a relation between

¹ MARSICK, V.J., WATKINS, K.E. (2001). *Informal and Incidental Learning. New Directions for Adult and Continuing Education*, issue 89, pp. 25-34.

learning content and worker's needs. Formal learning may vary from extremely relevant to completely irrelevant to workers' needs. New roles of workers demand outstanding technical knowledge (that is abreast with modern technologies) as well as perfect skills in interpersonal communication and teamworking. High-performance jobs usually require non-stop continuous learning about emerging technology, business relationships, and perspectives of all members in working community, including management, customers, and suppliers². The main drive for informal learning at the workplace is a need to meet organizational goals that cascade to workers in a form of incentives, such as increased worker participation in decision making and expanded job responsibilities. Another drive for informal learning is a desire to meet individual goals such as financial and psychological goals of recognition and personal achievement³. Through cross-training, trainees learn a) new job-specific skills, b) a character of co-worker or co-workers (personality and work ethic), c) how to integrate feedback, and d) effective social skills. Also, cross-training expands employee's horizon of observation - when an employee learns another task within the entire production process, particularly when it takes place out of his/her department, the employee's understanding of the task is redefined

² WALTON, R.E. (1985). Toward a strategy of eliciting employee commitment based on policies of mutuality. in R. E. WALTON & P. R. LAWRENCE (Eds.), *Human resource management: Trends and challenges*, Boston, Harvard Business School Press.

³ LIVINGSTONE, D.W. (1999). *Exploring the Icebergs of Adult Learning: Findings of the First Canadian Survey of Informal Learning Practices*. Canadian Journal for the Study of Adult Education, 13, pp. 49-72.

within the context of the whole process⁴. It is important to identify also employers, employees, SME owners, SME managers, HR managers and SME consultant's needs, because each of them is involved, from the organizational point of view, in informal learning from a different aspect.

Studies indicated that existing tools in many cases are lacking either a solid base in scientific knowledge about organization design or support for a sociotechnical systems perspective on organization design⁵. The research outcomes and presented considerations that are described below could be considered as a first step in this direction, bringing a patrimony of data and practices, with whom it will be easier design upcoming research projects with similar goals.

2. In the context depicted in the introduction, the research has followed a learning centered approach, identified as a distinct stream of research that differs from the psychological orientation of cognitive-perceptual research. This approach has been motivated by educationists addressing the diversity of the environment in which learning takes place⁶, and driven by process-based concerns relating to meeting individual differences and learning needs. The focus has shifted from concentrating on the constructs of intelligence and processing of information to an increased interest in learners' active response to the learn-

⁴ AGARWALA, T. (2003) *Innovative human resource practices and organizational commitment: an empirical investigation*, *International Journal of Human Resource Management*, 14(2), pp. 175-197.

⁵ MARKUS, M.L., MAJCHRZAK, A., GASSER L. (2002) *A design theory for systems that support emergent knowledge processes*, in *MIS Quarterly*, 26(3), pp. 179-212.

⁶ RIDING, R., RAYNER, S. (1998) *Cognitive Styles and Learning Strategies*, David Fulton Publishers, London.

ing task and to the learning environment. The learning centered tradition has grown out of process-based models of learning in workplace such as:

- the learning process as a form of experiential learning⁷;
- learners' orientations to learning⁸;
- workplace cognitive skills and strategy development⁹.

This stream of research on learning style shows that learners are dynamic and open to adaptation according to the particular context of learning. Criticism has been voiced about the learning-centered tradition of research on learning styles, on the basis that it represents an uncertain relationship between learning style and cognition and that concepts are poorly defined and used loosely¹⁰.

First of all the research team has focused on the identification of a taxonomy mainly related to the learning-centered tradition and focused on individual adjustments and approaches that arise while learners are engaged in the learning process. Learning at the workplace should become increasingly more popular for companies to achieve their short and long-term goals¹¹, but it is essential to address two sets of problems related to recognition of non-formal and informal learning.

⁷ KOLB, D.A. (1984) *Experiential Learning experience as a source of learning and development*, New Jersey, Prentice Hall.

⁸ ENTWISTLE, N. J. (1997) *Reconstituting approaches to learning: a response to Webb*. Higher Education, 33, pp. 212-218.

⁹ KEEFE, J. W., MONK, J. S. (1986) *Learning style profile examiners' manual*. Reston, National Association of Secondary School Principals, pp. 291-300.

¹⁰ BAERT, H. (2005) *Lifelong learning in a changing working environment*, in Labour Market Research and Policy Making in Flanders, Conference Book, pp. 195-224, Garant.

¹¹ SARGEANT, A. (1996) *Training for growth: how can education providers assist in the development of small businesses?*, Industrial & Commercial Training, vol. 28, 2, pp. 3-9.

The first group of problems is related to SMEs and their owners. On the one hand, SMEs are poorly informed about the benefits of and need for assessment of competences acquired in a non-formal and informal way. On the other hand, the lack of human, temporal and financial resources very often is a major obstacle in adopting procedures for assessment of competences and skills as practiced by large enterprises. The lack of knowledge on these problems weakens the competitiveness of SMEs and is a barrier for the transition to knowledge based economy.

The second group of problems is related to employees in SMEs. Vocational education and training of staff in SMEs often happens through on the job-training and practically performing a job.

Since the acquired skills and competences are often difficult to transfer, the taxonomy adopted was focused on the scope of project research and was integrated by the following categories:

- creating baseline knowledge;
- improving operational efficiency with collaboration tools and approaches;
- collaborating to create solutions to complex problems;
- improving employee performance with just-in-time resources;
- helping employees quickly resolve real world issues;
- fostering collaboration and innovation;
- expanding learning opportunities beyond what can be provided through formal training;
- addressing common knowledge gaps.

Designing a methodology for identification and recognition of non-formal and informal learning could help managers to give employees a better autonomy and better forms of experiential learning and skills. People tend to develop learning strategies in order to deal with learning materials and therefore learning strategies can be regarded as cognitive tools, which enable learners to complete tasks and solve problems. By relating the research on learning strategies to the design of learning environments it is possible to investigate how learners approach their learning, how they perceive of themselves as learners and what they value in the learning experience¹². In the last years, validation of non-formal and informal learning has become a key-element in national and European strategies for lifelong learning¹³. More and more countries have moved from a stage of initial testing and experimentation to full scale implementation where validation has become an integrated part of mainstream education, training and learning systems. Lifelong learning is defined as: all learning activity undertaken throughout life, with the aim of improving knowledge, skills and competence, within a personal, civic, social and/or employment-related perspective. Learning is understood here in terms of the social organization of learning activities which facilitate the communication and acquisition of

¹² VERMEERSCH, L., DE RICK, K. (2008) *SMEs and the participation of workers in formal learning*. Country report: Belgium, Lifelong Learning 2010 subproject 4, Leuven, HIVA, University of Leuven.

¹³ CASALINO, N., D'ATRI, A., FADDA, C. (2005) *Organisational impact and exploitation of the results of an Italian research project for e-health and medical training*. Proceedings of ECIS 2005 - European Conference on Information Systems, Regensburg, Germany.

knowledge and skills, also supported by information systems¹⁴. While there has been growing rediscovery of informal learning in recent years, it has proved much more difficult for employers to get a grip on its significance in the workplace. During the last fifteen years, networks have provided the basis for the use of e-mail and search software to enhance informal learning¹⁵. More recent developments include the application of social media to support informal learning activities through the virtual social networking among employees. Individuals in organizations have always exchanged their views, during lunch or informally during work, and after, but both small and large firms are now encouraging their employees to become involved in virtual social networking. This raises a series of ethical questions with regard to the management of social networking as a part of informal learning. Employers now make use of Facebook and such other social networking platforms. Many companies now require existing employees to demonstrate their activities on professional networks such as LinkedIn or distinctive groupware platforms. It is clear that these “social” technologies can also be used for the social control through the tracking of messages in order to verify and discipline individual employees in organizations¹⁶.

According to Markus et al. there are several design problem of providing IT support for emerging knowledge processes (EKPs). They are defined as: “organi-

¹⁴ EARNFILE (2009-2011) project results, in final report *“Evaluation And Recognition of Non-formal and Informal Learning”*, project number LLP-LDV-PA-09-IT-0276, Leonardo Da Vinci Partnership project, financed by EU Lifelong Learning Programme.

¹⁵ JOHNSTON, K., LOADER, K. (2003) *Encouraging SME participation in training: identifying practical approaches*, Journal of European Industrial Training, vol. 27, n.6, pp. 273-280.

¹⁶ OVERWIEN, B. (2000) *Informal Learning and the Role of Social Movements*. International Review of Education, 46 (6), pp. 621-640.

zational activity patterns that exhibit three characteristics in combination: an emergent process of deliberations with no best structure or sequence; requirements for knowledge that are complex, distributed across people, and evolving dynamically; and an actor set that is unpredictable in terms of job roles or prior knowledge". Organizational requirements about the emergent knowledge design are critical processes for manufacturing sector, since it is known to be associated with good or poor performance on such measures as productivity, cost, quality and cycle time¹⁷. The reflections above have important implications about the development of procedures for the accreditation of informal learning in the workplace. On the one hand, the recognition of intentionality in informal learning offers a number of opportunities to adopt and develop instruments such as learning portfolios and learning diaries which provide opportunities to record the significant learning experiences and accomplishments of individuals. On the other hand, incidental learning, and, in particular tacit learning, gives rise to important issues about the recognition of learning experiences and social control within organizations. For this reason it was decided to apply the well-known model of the learning process derived from the Kolb's theory of experiential learning as the basis for design of traditional learning contents and to combine this with other information gained about the target learners¹⁸. The core of it is that learners progress through a learning cycle in which experience leads to observation and reflection, which then leads to concept formation.

¹⁷ SENGE, P.M. (1990) *The Fifth Discipline: The Art and Practice of the Learning Organization*. New York, NY.

¹⁸ JÖRISSEN, B., MAROTZKI, W. (2009) *Medienbildung - Eine Einführung. Theorie, Methoden, Analysen*. Bad Heilbrunn, Klinkhardt.

Kolb's learning theory sets out four distinct learning preferences, which are based on a four-stage learning cycle. In this respect Kolb's model is particularly relevant, since it offers both a way to understand individual people's different learning styles, and also an explanation of a cycle of experiential learning that applies to us all. Kolb includes cycle of learning as an essential principle in which "immediate or concrete experiences" deliver a basis for "observations and reflections". These "observations and reflections" are assimilated and distilled into "abstract concepts" producing new implications for action which can be "actively tested" in turn creating new experiences. Kolb says that ideally this process represents a learning cycle or spiral where the learner "touches all the bases", i.e. a cycle of experiencing, reflecting, thinking and acting. Immediate or concrete experiences lead to observations and reflections. These reflections are then assimilated into abstract concepts with implications for action, which the person can actively test and experiment with, which in turn enable the creation of new experiences. The involvement of SME employees in learning activities means it remains challenging due to several obstacles. Employers and employees have different expectations, while the lack of managerial attention to the subject can lead to confusion among employees about the extent of company support.

3. Regarding the boundaries of the research, the activity included the collection and the study of results of the two year (2009-2011) Leonardo Da Vinci Partnership project, financed by EU Lifelong Learning Programme and entitled "Evaluation and Recognition of Non-formal and Informal Learning" – EARN-

FILE¹⁹. The partnership involved was composed by a network of research institutions and vocational training organizations to reach the goals established from different perspectives. The research team included the following partners:

- a private consultancy company that provides vocational training to SMEs in quality management systems and implementation of EU financed projects - “European Center for quality” - ECQ, Bulgaria;
- an university research center that studies and adopts innovative learning methodologies - Research Center on Information Systems of LUISS University - CeRSI, Italy;
- a private non-profit research center - MERIG, Austria;
- a private company that provides trainings, adult education and consultancy services related to career guidance - Roemeling Projectleiding - The Netherlands;
- a public non-profit organization – a department within the Ministry of Education of Belgium, French speaking community - CCG, Belgium.

Given the scope of the research and the investigation method chosen (interviews and multiple case study analysis), it was not easy to find suitable SMEs willing to participate in the study. More features of the sources has been identified by the adoption of a research strategy based also on the information available on web-sites and with the performing of an electronic survey.

First approaches to companies led to arrangements to talk to ten SMEs, five in the manufacturing sector and five in the services sector (business-to-

¹⁹ EARNFILE (2009-2011) project results, in final report “*Evaluation And Recognition of Non-formal and Informal Learning*”, project number LLP-LDV-PA-09-IT-0276, Leonardo Da Vinci Partnership project, financed by EU Lifelong Learning Programme.

business). The research team selected two for each partner Country from several business employing less than 50 people (50% of SMEs interviewed in the project); and 50 or more but less than 250 people for a medium business (50% of the remaining SMEs).

Many of the employers contacted initially, stated that they had no information on their employees' informal educational activities. After in-depth interview of each case following also the Yin methodology, the research team understood that there was a complex mosaic of learning issues in that SMEs. The research question was addressed by conducting an exploratory analysis of that SMEs situation and the cases analyzed provided a light, but well differentiated, picture of employer-supported formal training.

Unfortunately, owing to the strict budget limitations of the project, it was not possible to adopt the Markus et al. design theory and its set of six combined design and development principles for emerging knowledge processes. It will be useful in the future for a better analysis of each case and for capturing the richness of design theory in a way that simple verbal guidelines to designers cannot.

In total the project research group has done 125 phone calls and has sent about 250 emails: on average 12,5 phone calls have been made and 25 emails have been sent to each SME. The number of direct contacts needed, testifies the troubles faced in the identification of the exact person of reference and the delay in the return of a filled survey. In most cases the inertia of the process can be addressed to the set of steps necessary to directly interact with the head of the identified person.

The investigation had some important practical implications for the research team, as it furthers the understanding of how to maximize relationship performance in SMEs environments, thanks also to the adoption of online collaboration environments (CMS, emails, e-voting tools, etc.).

4. It is difficult for an SME manager to oppose employee's wishes to improve their education, because there are too many obstacles which delay the participation of employees in education²⁰. As any behavioral model, for Kolb's study nevertheless people clearly exhibit clear strong preferences for a given learning style. The ability to use or change frequently learning styles is not one that we should assume comes easily or naturally to many people. Simply, people who have a clear learning style preference, for whatever reason, will tend to learn more effectively if learning is orientated according to their preference. So how much informal learning is actually occurring in companies analyzed?

The project investigation highlighted the following aspects: uncertainty about the return on investments; time pressures; mismatch between training needs and training supply. In terms of the widely accepted "iceberg metaphor" of learning activities, only 20% of learning activities are formal and 25% non-formal, while 55% of other learning activities are informal. Informal learning represents a largely overlooked dimension of learning activities in the workplace

²⁰ KOMAR, R. (2008) *Medienkommunikation und Design*. In SCHACHTNER, C. & HÖBER, A. *Learning Communities*. Frankfurt, Campus Verlag, pp. 83-95.

and enhancement of performance on the job²¹. Informal learning is increasingly engaged in the compression of time and space which is results from the rapid and all-embracing development of the virtual media

The outcomes achieved also reveal that the difficulties to participation are often connected to each other.

Removing limitations requires a detailed understanding of all factors, taken not only separately but also as a cluster of arguments that influence the enterprise's training policy or training culture. For instance, a lack of time, funds and other similar constraints might lead to a lack of interest in education for employees. According again to the study, part of the problems relating to SME involvement can be attributed to the different expectations of employers and employees towards lifelong learning. Both employers and employees seem to consider participation in informal education primarily as a way to strengthen knowledge, know-how and productivity and regard such education as goal-oriented. For employees, however, this view is complemented by a broader lifelong learning expectation particularly in terms of self-development as well as career enhancement. Because most of the SMEs involved in the study have a rather informal training policy, their managers risk becoming preoccupied with day-to-day concerns and failing to pay attention to learning and education, or becoming reluctant to acknowledge the need for it. Another risk is that, due to the lack of training measures, employees may no longer know what support to expect from the company or where to turn to with their specific learning de-

²¹ SHERIF M., HARVEY O. J., JACK WHITE B., HOOD R. W., SHERIF W. C. (1954) *Intergroup Conflict and Cooperation: The Robbers Cave Experiment*, Strategic Management of Technological Innovation Journal, NY.

mands. Although this project has its time limitations, it adds some new perspectives to current knowledge of the skills and training challenge within SMEs. The most remarkable perspective is that a lack of managerial attention has the additional effect of leaving employees not knowing what to expect in relation to training and showing an increasing lack of interest in the matter²².

Organizational learning is mediated by several factors, both personal and environmental in nature. Everybody learns in accordance with their unique, individualized blend of personal and environmental factors. Few organizations have been able to infuse organization design expertise throughout their standard industrial processes because of the characteristics of emerging knowledge processes (process development, irregular user types and usage frameworks and spread skilled knowledge).

Personal factors measured by the online questionnaires were initially some individual factors like motivation, interests and abilities which predispose an individual towards learning²³. They are the following aspects:

- interaction aptitude;
- interests;
- readiness;
- experience;
- motivation;
- self-concept;

²² MORECROFT, J.D.W., STERMAN, J. (2000) Modeling for learning organization. *Productivity Press*, Oregon.

²³ MINER, A., MEZIAS S. (1996) Ugly duckling no more: Past and futures of organizational learning research. *Organization Science*, 7/1, pp. 88–99.

- attitudes;
- values;
- level of aspiration;
- learning style;
- workplace setting.

Environmental factors on the other hand, are those contextual factors which highlight the role of the environment in learning, such as the socio-emotional, social and cultural factors.

For the research, the team identified and formalized some environmental elements that can summarize the different contexts. They can be classified into the following categories²⁴:

Available resources. Learning is greatly enhanced when necessary resources are available. Making knowledge available to employees communicates management's commitment to and value of learning and knowledge.

Incentives structure. Providing incentives for learning is one of the most important factors affecting informal learning in the workplace. Incentives reinforce the desired learning behaviors and greatly increase their occurrence.

Promotion criteria and recognition. The criteria by which organizations determine who gets promoted communicates to employees the importance of learning. Organizations that promote on the basis of merit reinforce the value of quality performance. Employees will try to learn and improve if their efforts are recognized.

²⁴ CROSS, J. (2006) Informal Learning. Rediscovering the Natural Pathways that Inspire Innovation and Performance, Pfeiffer, San Francisco.

Financial incentives. Learning, that is financially rewarded, is valued and sought out by employees. Also providing incentives for learning communicates the value that the organization places on learning.

Job security. When employees feel their job is secure and the possibility of getting fired is low they may be unmotivated to expand their job scope. When job security is paired with reinforcement for job performance or career advancement, employees are motivated to learn, try new things and explore new opportunities. When job security is low, employees will attempt to perform their job in the best possible way avoiding any risks or standing out in the crowd in any way perceived as threatening.

Management employee relationships. Relationships between management and employees affect the overall atmosphere in the workplace. Management usually wants employees to produce more and employees want higher wages. The extent of the tension between the two depends to a large extent on the mutual understanding and acceptance of each other's goals. The greater the overlap in the understanding and goals, the lesser the tension between the two. The alienation between the individual and the company creates an atmosphere where learning is perceived as contributing to the company and rather than to the individual.

Size of organization. The organization's size contributes to the sense of community level of understanding of one's place within the organization. In small organizations employees will all know each other and sense the community and this will increase the extent to which they can ask each other questions and learn more from one another.

Working environment. The physical characteristics of the working environment should ideally be of such quality that no offence is given to any of the five senses (well-being at work, noise, vibrations, lighting, air quality, work space). Louder noise for example may lead distraction. The concentration on the work at hand may be more or less hampered by the environmental noise. Conversely, extremely low levels of noise may also be experienced as irritating and thereby have an adverse effect on attention.

Social control on work meetings. Learning comes from interaction through personal meetings in which people debate different things. The topics discussed between colleagues can be improved when there is someone who supervises the meeting.

Learning culture. To become a learning organization is to accept a set of attitudes, values and practices that support the process of continuous learning within the organization. Through learning, individuals can re-interpret their world and their relationship to it. A true learning culture continuously challenges its own methods and ways of doing things. This ensures continuous improvement and the capacity to change. According to Senge learning organizations are: "...organizations where people continually expand their capacity to create the results they truly desire, where new and expansive patterns of thinking are nurtured, where collective aspiration is set free, and where people are continually learning to see the whole together".

The learner and the learning process can only be completely understood with reference to the interaction of both environmental and personal factors.

5. In recent years a rapid proliferation of forums, blogs, chats, podcasts and similar services has therefore occurred. Knowledge is therefore no longer receptively processed but rather actively acquired²⁵. In another recent study about the participation of workers on formal and informal learning in SMEs by University of Leuven, the results showed that: two-thirds of small businesses use social media to promote or improve their activities. Use of social media is becoming more common among SMEs. It's easy to see why it has proved so popular for small business marketers in a recession: they are free to use and have virtually limitless reach. As a result, companies of all sizes need to work harder than ever not just to deliver high-quality user service but to do so in an efficient and timely manner. For SMEs these pressures are particularly intense. It is not easy for them to maintain and develop worker fidelity in the face of fierce competition from larger rivals that have both the manpower and financial resources.

In this context, the arrival of social networks as a way to real communication and interaction with users should be seen as an opportunity. SMEs need to modify the idea that many of their users are not only online and in the cloud but are talking about their products and services while they are there. If they have a problem, they are likely to post a comment on Facebook or tweet about it on Twitter. So businesses are now having to engage with their users wherever they are and find a solution in real-time before potential problems escalate. In essence, SMEs who are not engaged in social networking risk being left behind

²⁵ CASALINO, N., DI PERSIO, F. (2004) *Integrating medical services, training and education: the HERMES project platform*, in ATL - Advanced Technology for Learning Journal, ACTA Press Anaheim - Calgary - Zurich, Vol. 1, Issue 2, pp. 71-80.

and losing business to competitors who respond to issues more quickly. These can then be used to proactively address any future issues arising and can even be posted as part of specially developed “answers” or “ideas” forms, which can be published on the company website to support user self-service. Today, however, by using applications to manage all user interactions, the situation has been reversed. Social networking activity is now rightly perceived as a potential opportunity by most businesses, including many SMEs. Learning pills, in the context of Web 2.0, is viewed as part of a dynamic, open and fragmented digital environment, in which information can be individually produced, aggregated, used and reused. Social software may be viewed as a major component of Web 2.0 and can be characterized by its capability to support social interaction. Learning supported by social software enables not only short and flexible formats or rapid delivery of content, but also social interactions based on that content. This aspect is also an integral part of online communities, where learners connect as they create, aggregate, share, use and re-purpose content, including smaller content chunks. Learning pills is also related to work-based learning with the term individual training used to describe short work-based training formats. It can be used as a component of formal blended learning, as means to support informal learning at the workplace, or as self-contained training. As such learning pills can add value to organizations, as it enables flexible learning and requires less investment in terms of time and resources. However, the real value-added of training combined with Web 2.0 and social software is its capability to integrate short formats with user-generated content and social interaction. Employees should use the accreditation process in order to get their

newly acquired skills certificated so that they can take their achievements to provide evidence for formal qualifications or for entry to new programs of study or to new employers. There are several methods and techniques to collect evidence to provide a basis for judgments about whether learning (skills and competences) has been acquired. Web 2.0 provides to different learning skills (structuring, research, cooperating, producing, presents Ireland) their appropriate technologies. Media is not to be understood only as a tool in the learning process, but it is such an integral part of modern society, that its use has become an active part of social participation²⁶. Even nowadays it still seems difficult to integrate the use of media in teaching and training situations. The competence to use media is not seen as one of the most important skills by teachers, trainers or tutors²⁷. Here, educational institutions should support the continuing professional development of their staff members. Since media literacy of teachers/trainers is a key for higher quality in lifelong learning all over Europe.

Learning is becoming an active, self-directed, useful, social and situational process; current technological, economic and social changes are producing the need for new concepts and strategies to support lifelong learning. Education, including work-based learning, is in need of transformations, requiring renewal

²⁶ McLoughlin, C. (1999) *The implications of the research literature on learning styles for the design of instructional material*, *Australian Journal of Educational Technology*, University of New England 15 (3), pp. 222-241.

²⁷ Casalino, N., D'Atri, A., Manev, L. (2007) *A quality management training system on ISO standards for enhancing competitiveness of SMEs*, *Proc. 9th International Conference on Enterprise Information Systems – ICEIS 2007*, Funchal, Madeira, Portugal, Cardoso, J., Cordero, J., Filipe, J. Eds., INSTICC, pp. 229-235.

and innovative ways of relating appropriately to the way we live, work and learn today. Social media bring about such socio-cultural changes as the do-it-yourself-culture, with individuals becoming actively involved in co-creation of cultural assets beyond formal structures, changing from consumers to producers, thus becoming so-called “pro-sumers”. These new digital technologies enable the design of user-generated content and have given rise to a trend towards small formats, i.e. short, simple and targeted information²⁸.

Together with personal publishing systems, such as blogs or wikis, it has become fairly easy for anyone to create own content. Small contents, i.e. information published in short form, relate more to a formal approach of how to present content rather than the inherent quality of the content itself. Examples of small content include podcasts, blog posts, wiki pages or short messages on Facebook or in Twitter.

Creating, publishing and sharing of informal contents on the Web open up new possibilities for implicit, informal and incidental forms of learning, such as learning pills, the term referring to short learning activities. The smartest SMEs and the executives who work for them recognize the value to capture the best answers and the most innovative ideas. Often, instead of calling the supplier directly, users will simply access Facebook, comment on the problem they are having and ask for input, or alternatively they will tweet about it on Twitter in order to draw on the expertise available in the online community. SMEs need to be aware of discussions on sites, such as Twitter and Facebook, monitoring and tracking them. Where appropriate, they also have an opportunity to intervene,

²⁸ LAUDON, K., LAUDON, J. (2011) *Management Information Systems*, Kindle.

initiate insightful debate, and capture relevant knowledge that makes them look smarter and allows them to harness the innovative potential of the community. They can search by keywords that allow them to identify relevant discussions. They can then develop suitable answers that can be posted on Facebook and sent to whole communities via Twitter. These answers can subsequently be used to help in the development of knowledge bases - essentially repositories of key information about a particular issue. These can then be used to proactively address any future issues arising and can even be posted as part of specially developed “answers” or “ideas” forms, which can be published on the company website to support user self-service²⁹. However, to be successful from the organizational point of view, companies need to be able to respond quickly. If users have a problem with a product or service, any delay in responding may result in lost business. It is important too that organizations are able to obtain direct feedback on the quality of the content they create or approach they develop. They need to ensure that they have a mechanism in place to allow their user community to provide relevant feedback and comments, and vote to promote or demote files, web links, documents or ideas. The organizational result will be a more active and involved community and, for the SME, clearer insight into what their users and prospects are thinking. In the past, the ability to deliver the kind of approach outlined above would have been well beyond the reach of most service organizations, particularly SMEs. Indeed, many such businesses would have seen this kind of activity as a potential threat to their reputation

²⁹ WATTS, D.J., MUHAMAD, R., DODDS, P.S. (2003) *An experimental study of search in global social networks*, *Science*, 301, pp. 827-829.

and brand. Today, however, by using applications to manage all user interactions, the situation has been reversed. Social networking activity is now rightly perceived as a potential opportunity by most businesses, including many SMEs. Short learning activities with a length of a few seconds up to about fifteen minutes and can be easily and flexibly integrated into everyday activities. Small content as input and output of learning can be created and used in the transition from learning communities through communities of practice to learning networks, bridging the gap between formal and informal learning. Learning pills can either take place within emergent small content structures such as blogs or vlogs, or it can take place within a designed setting in form of e-learning. E-learning 2.0 can be described as a new approach to e-learning facilitated by Web 2.0 and social software. Unlike e-learning 1.0 focusing on composing, organizing and packaging content, E-Learning 2.0 enables learners to syndicate, aggregate, remix and repurpose content according to individual aims and needs. Learning activities, especially in context of informal learning, can be integrated into individual learning environments³⁰. They can be described as a collection of interoperating applications. In this way they support learners in aggregating small chunks of content, such as feeds and widgets, in a personal learning center by pulling external content, combining different content units and distributing the result within the organization.

³⁰ CASALINO, N., DI PERSIO, F. (2004) *Integrating medical services, training and education: the HERMES project platform*, in *ATL - Advanced Technology for Learning Journal*, ACTA Press Anaheim - Calgary - Zurich, Vol. 1, Issue 2, pp. 71-80.

6. Starting from the main organizational studies, organizational learning addresses ways in which information processing affects the behavioral capacities of organizations³¹. Organizations also learn “vicariously” by picking up information from external sources, for example by adopting technical solutions practiced by competitors or advised by regulators. Frequent repetition of activities leads to acquisition of tacit knowledge. The literature has also discussed whether learning is incremental or radical. However, Miner and Mezias have argued that it is no longer an issue of concern and pointed that there is a consensus that learning can be both incremental and radical. Among the recent debates in the field was also the distinction between organizational learning and learning organization³² very close to SMEs context.

A first outcome regards if employees should use an accreditation process in order to get their newly acquired skills certificated so that they can take their achievements to provide evidence for formal qualifications or for entry to new programs of study. In the validation process there are different methods to collect evidence of learning, skills or competences. They can be divided into five categories:

Examination. Candidates answer questions (oral or written) on a domain of study. They can focus on a domain or be interdisciplinary in nature. Questions can be open or closed (essay, multiple-choice). The evaluator can be a third par-

³¹ EARNFILE (2009-2011) project results, in final report “*Evaluation And Recognition of Non-formal and Informal Learning*”, project number LLP-LDV-PA-09-IT-0276, Leonardo Da Vinci Partnership project, financed by EU Lifelong Learning Programme.

³² MORECROFT, J.D.W., STERMAN, J. (2000) *Modeling for learning organization*. Productivity Press, Oregon.

ty. Apart from the classical regular (written and or oral) examination (which can take various forms, from tests to essays), there are cases in which non-formal and informal learning are taken into consideration.

Declarative. Candidates declare and justify (orally and in writing) that what they can do corresponds to certain parts of the curriculum taught in the education or training program for which they would like to obtain credit. A panel (third party) gives the final judgment. Once evidence is collected, it needs to be documented. Examples have been examined for non-formal and informal learning and have been classified into three categories: the check-up of competence; the portfolio and the certification of competences. The portfolio presents a synthesis of the personal, social and occupational experiences to highlight competences. It contains elements from the Curriculum Vitae, relevant information on the career, education, training and other experience. A good portfolio is needed to showcase one's work and to help to demonstrate one's skills to prospective employers.

Observation. Following certain rules and strict methods, an evaluator (third party) observes candidates in situ and judges whether they have the competence described in a standard. Observation is a more demanding exercise than one can imagine. Methodology and training are required for the assessor to properly collect relevant and reliable observations. Direct observation of competences is used for the assessment in practical work situation. So, the observation of activities can take place in real work settings, or it can be based on past experience with the candidate or on a simulated work situation.

Simulation. Candidates are placed in a context that presents all the characteristics of the real work (or other) situation and are then able to demonstrate their competences. Simulation requires a large amount of studies and job analysis to be prepared properly. Often judgment is by a third party. The major difficulty is the job analysis needed to support a simulation to be valid and reliable.

Evidence extracted. Based on the descriptions of assessment standards, candidates collect evidence of skills and competences in the real work situation.

The research group has noticed also a certain degree of approximation and incompleteness of the information provided by the workers, but clearly understand that they need to be co-participants in learning, not simply receivers. In a recent study a researcher explained the training industry interest in informal learning³³ saying: “Training professionals are paying attention to informal learning because formal learning has run out of steam. Workers don’t have time for the inefficiencies of old-style training. For years, we’ve talked about giving people what they need, when they need it. Internet makes it feasible to deliver on that promise. Learning often is distributed and includes both general expertise and local context knowledge. The essence of many jobs is routine and doesn’t offer any challenge to the employee. So it is important to give employees challenges, problems to solve, new activities in their existing job which challenge them to learn new skills and knowledge. Non-formal and informal learning creates interest and commitment of employees and leads to formal learning as

³³ MINER, A., MEZIAS S. (1996) *Ugly duckling no more: Pasts and futures of organizational learning research*, *Organization Science*, 7/1, pp. 88–99.

well. Another idea is to give employees the opportunity to have their skills, knowledge and competencies recognized, initiate procedures for this, encourage employees to be involved in this, give support to the process and when finalized, reward employees appropriately (salary, job level, position). Allow employees to have access the required resources like time, opportunities, material, money, Internet access.

Social media have an important role in the learning and development of today's business professionals. Ignoring social media's informal learning influence is equal to ignoring the fact that a new generation of workers adept at and immersed in social media are beginning to flood the market. So it is important to identify the social media tools you feel are most beneficial to enterprise and endorse them as workplace-friendly learning resources. If employees know that LinkedIn is considered a work-friendly workplace tool, but not MySpace or Facebook, they have guidelines for their informal learning choices. Some businesses especially those with heavy regulatory restrictions will choose to create internal collaboration and social media applications that allow for the rich networking and information-sharing abilities while minimizing security and confidentiality risks³⁴. Others will align social media sites and tools with their industry and guide employees to the resources that offer the most learning potential. Mailing software applications are main tools often used for "official" communications in the organizations. Sometimes the mailing communication is a time consuming activity. In such cases the instant messengers software can be

³⁴ CROSS, J. (2006) *Informal Learning. Rediscovering the Natural Pathways that Inspire Innovation and Performance*, Pfeiffer, San Francisco.

preferred. A way can be to install and use a groupware in an organization. Many of these solutions for managing corporate knowledge are also open-source.

7. Learning at the workplace takes place in different settings and contexts, in formal, non-formal as well as informal environments, and can be conceived as the social organization of learning activities. Learning that takes place in formal education and training environments is the most visible and have dominated educational policy and practice for a long time. In recent years, however, there has been a growing understanding that learning in non-formal and informal settings are equally fundamental for the lifelong learning achievement, thus requiring new strategies for identification and validation of more invisible learning environments³⁵. Besides it is nearly impossible to envisage in advance in each case who will take part in the process and which platform they will adopt.

From the perspective of lifelong learning it is essential that key competencies are learned, updated and retained during life.

Over and above the business benefits, today's employees appreciate the personal and professional development informal learning can lend to their lives and careers, through tools such as instant messaging, e-learning support groups, expert communities, mentor and coaching networks, personal learning portals and moderated chats. It is important to promote an incentive structure of learning culture in the company trying to communicate to all employees in the organization that new ideas are highly valued and that each new idea shall be

³⁵ Feutrie, M. (2009) *Validation of Non Formal and Informal Learning in Europe, comparative approaches, challenges and possibilities*, Université des Sciences et Technologies de Lille, France.

responded to, regardless of its worth to the organization. Innovative employees have to be promoted when teams find a way to improve the information processes in an organization.

Employers should be open-minded and assure their employees that their door is always open for new suggestions and opinions. So it is needed to improve transparency by implementing a better horizontal and vertical communication in management skills and especially by explaining career development opportunities. The major purposes of downward communication are to advise, inform, direct, instruct and evaluate employees to provide organization members with information about organizational goals and policies. While the main function of upward communication is to supply information to the upper levels about what is happening at the lower levels³⁶. This type of communication have to include progress reports, suggestions, explanations and requests for supports or decisions. At the European level, the Commission stated that there is a need to develop a set of common principles regarding validation of non-formal and informal learning with the aim of ensuring greater comparability between approaches in different countries and at different level.

The availability of a patrimony of experiences, among which some possibility similar to the new one to be designed, can contribute as an incentive to the governance of non-formal and informal learning, together with knowledge management systems and, at the same time, to the improvement of organizational learning issues. The research described and the first considerations

³⁶ AGARWALA, T. (2003) *Innovative human resource practices and organizational commitment: an empirical investigation*, *International Journal of Human Resource Management*, 14 (2), pp. 175-197.

transpired might then be considered as a first step in this direction, bringing an important set of data and practices, with whom it will be easier design upcoming researches with similar goals.

THE PROFESSIONS IN THE PHASE OF GLOBAL ECONOMIC CRISIS

Guido Alpa*

*“Justice requires (...) that access to any profession be open,
without privileges and exceptions, to all those who prove to be capable of practicing it.*

*It also requires that, precisely due to the technical ability shown,
everyone can contribute to define the rules governing their respective profession,
thus contributing to protect the common interests of those who devote themselves to it,
subject to the laws safeguarding the general interest
(professional justice)”*

*Giorgio Del Vecchio Speech delivered on November 19, 1922 for the inauguration of the
Rome University academic year (Annuario 1922-1923).*

ABSTRACT: *Intellectual professions, and the legal profession in particular,
are floundering in an emergency situation. The economic crisis has not been
the main cause of the debasement of the legal profession: this process of
deterioration of the role played by lawyers started with the implementation
of the free competition principles and the assimilation of the professional
activity to the business one. However, professions cannot be assimilated to
the mere provision of a service and citizens rights, defended by lawyers, are
not commodities such as goods, services and capital. The reforms currently
discussed, such as the Italian legal profession reform, are influenced by an
entrepreneurial and business logic. Such reforms, instead of giving priority*

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to economic values and principles, should follow the widespread principles established by the European Parliament's Resolution of May 23, 2006.

SUMMARY: 1. Background. - 2. The economic dimension. - 3. The professions and professionals' partnerships. - 4. Parliamentary hearings and the geography of areas of jurisdictions. - 5. Lawyers in the European Parliament's resolution (2006).

1. This analysis reflects the fact that currently the intellectual professions, and the legal profession in particular, are floundering in an emergency situation. The world in which we already lived with difficulty has changed completely, thus adding risks and negative factors to the previous situation. Moreover, further changes are expected to take place as a result of the adoption of the bill for the legal profession reform being discussed in the House of Deputies (AC 1390) and the implementation of the regulation on professions prepared by the Justice Ministry, currently submitted to the Council of State opinion².

Both reforms are closely interwoven and, considering that the legal profession is one of the pillars of the Rule of Law and a profession which has the right and duty to assist citizens in gaining access to justice, it would be illogical and even politically wrong to effect changes in justice administration without the legal profession cooperation, as well as changing the lawyers' status without appreciating the role they play within the judicial system. Nevertheless, in spite of Hegelian theories, we do not live in a rational world and we are experiencing

² See draft Ministerial Decree on professions.

a phase in which we tend to ignore the problems besetting the legal profession and the measures which could support it in the valuable and painstaking activity that lawyers take upon themselves to perform their mission and stand in for the judiciary in their tasks.

Unfortunately, in the analyses made over the last few years on the occasion of official ceremonies, workshops and conferences, but also in the presentation of books which provide useful suggestions to improve the current situation, not to mention the studies, papers and reports drafted by the relevant institutions, no reference is made to this activity performed by the legal profession, as if the thousands of judges of the peace, honorary judges and lawyers who are members of the judiciary councils were a mere decorative element of the system rather than a means to make it work.

Likewise, while assessing the best choices to regulate the legal profession, the institutions have seldom recognized or praised the role played by those who practice a unique profession, which cannot be assimilated to the mere provision of a service, or entrusted to the usual mechanisms and principles of entrepreneurial and business activities. In the citizens and weak stakeholders' interest, this profession needs strength, independence and autonomy to be able to fulfil its mission: if these values are lost and the specificities of this profession are straitjacketed in uniform rules for all professions, we end up by undermining it and the whole "justice system".

The particular economic situation has imposed new interpretation keys and new prospects for analysing justice, which now are the guiding light for any measure taken in this field – a sort of primary and exclusive evaluation imposed

on the lawmaker, the government and all those who operate inside the judicial system and those who resort to it. The problem lies in the fact that these interpretations keys and new prospects cannot be considered in isolation as if it were possible to overgeneralize a phenomenon which, on the contrary, encompasses century-old moral and social values which cannot be passed over without distorting, misrepresenting and even sap it.

2. On many occasions the Italian Bar Council has promoted a debate on this one-way prospect: in particular, this matter was discussed during the conference organized at the House of Deputies on July 15, 2011.

The topic was also tackled during the legal refresher course organized last March. In particular, the issue was raised by Prof. Francesco Capriglione, who examined the causes and impact of the economic crisis and Prof. Vincenzo Cerulli Irelli, who analysed the limits to private autonomy imposed by the State to face the crisis.

The topic was also specifically discussed in the presentation of two important analyses: the former made by the Vice-President of the Higher Council of the Judiciary, Hon. Michele Vietti, entitled *La fatica dei giusti* (Milan, 2011), which does not regard only judges, but describes the activity performed by those who contribute to the functioning and operation of the judicial system; the latter made by the President of the Class of Moral, Historical and Philological Sciences and Vice-President of the *Accademia Nazionale dei Lincei*, Prof. Alberto Quadrio Curzio, who wrote a book entitled *Economia oltre la crisi* (Brescia, 2011), in which professionals and lawyers are given credit for contributing

not only to the GDP creation, but also to the solution of citizens', companies', Public Administration's and institutions' problems.

With a view to underlining that the one-way analysis based on economic principles cannot be accepted, irrespective of the situation in which we are forced to live, the Italian Bar Council and the other members of the legal profession who organized the 30th National Bar Congress gave an emphatic, but significant, title to it - "*Rights are not commodities*" (Milan, March 23-24, 2012), thus reaffirming the primacy of law over the other social sciences, as well the primacy of the legal organization over the other societal forms of expression.

Not even the most extreme *liberals* – obviously I am not speaking about free traders or the advocates of social market economy – had gone so far to preach the all-pervasiveness of economic rules and their self-sufficiency. The historical studies made for celebrating the 150th anniversary of Italy's Unity corroborate this assumption³.

Lawyers - the defenders of rights in a democratic State – recall that economic globalization cannot run people's rights roughshod, particularly where they can boast a long-standing tradition and are the most significant feature of the Western political and historical model. Not even the severe crisis, which has hit the whole world and Italy, can justify the relinquishment of that model. Quite the reverse. Whenever we wished to depart from that model by giving priority to economic values and principles we headed for disaster: the law shortcomings, allowed by a free trade market approach fully uninterested in

³ A case in point is the collection of letters between Benedetto Croce and Luigi Einaudi recalled by Natalino Irti in his book *Dialogo sul liberalismo*, Bologna, 2012.

people's human and financial rights, have led to the tragic situation in which we are obliged to live – a sort of revolution not dictated by policy or social claims, but imposed by those who pull the strings of financial markets. This economic and financial matrix, resulting from the mistakes made by economists and the *establishment*, determined not to prevent the *credit crunch* and now uncertain on the remedies to take, had other precedents in human history which we could overcome by recovering the values of a sound, shared and participatory democracy based on law and rights.

Hence, rights are not commodities since they cannot be equated with goods, services and capital. People are the primary values that a modern State must consider and the drastic and irreversible retrenchment of the Welfare State cannot be pursued without concerted discussion and large consensus.

The Europe of rights does not impose rampant liberalizations, and those who maintain that measures other than those needed to reduce public debt and relaunch the economy are dictated by Europe make an ideological use of Community law. Rights are not commodities because they are not a bargaining chip and cannot be constrained into compressed trial formula as if they had to be shut up in a bottle. Rights are not commodities because they cannot be de-based, hampered by high costs to have access to justice or entrusted to compulsory conciliation or alternative dispute resolution (ADR) procedures mostly managed by incompetent people. Rights are not commodities because they cannot be defended by lawyers slave to partners. Rights are not commodities because they cannot be transferred from territorial judicial units to regional or provincial sorting centres.

This is the reason why the whole legal profession has launched a cry of alarm towards institutions, members of Parliament and citizens: the justice system and the legal profession cannot be reformed without involving lawyers.

Justice is an insuppressible State task and the system to administer it cannot be dismantled or emptied out as if it were a storehouse of damaged goods. Giorgio Del Vecchio' solemn words I have quoted at the beginning of my report, delivered just few days before the March on Rome, sound as a warning on which everybody should ponder.

The legal profession must remain independent and autonomous to fulfil its institutional tasks. Those who hit the defenders of rights hit rights and, hence, reduce democracy.

Moreover, it can be easily noted that competition in the legal profession has long been a reality. Going beyond means taking measures contrary to the proportionality and subsidiarity principles. Going beyond means hitting intermediate communities, the Bar rolls and associations with which the legal profession is self-regulated by virtue of its autonomy. Going beyond means commodifying any relationship, giving preference to the stronger party over the weaker, to the richer party over the poorer – in other words jeopardizing the values enshrined by the Constitution and the Nice Charter, the values of free societies. Conversely, our task is “globalize rights”, as hoped for by Noam Chomsky, Vandana Shiva and Joseph E. Stiglitz⁴.

⁴ See *La debolezza del più forte. Globalizzazione e diritti umani*, Milan, 2004.

3. The economic crisis has not been the main cause of this debasement of the legal profession: this process of deterioration of the role played by lawyers in civil society started when we began to implement – in a fully dull and flat way – the free competition principles and when we wished to assimilate the professional activity to the business one. It started when we decided to undermine the systems based on professional rolls and associations and to abolish the criteria for setting professional fees parameterized on the basis of social needs. This was done in spite of the pivotal role played by the professions to the community's benefit. It is by no mere coincidence that their role is recognized and enshrined in the Italian Constitution and the Charter of Fundamental Rights of the European Union. Considering that the professions are essential for societies – as noted one year ago by Francesco Galgano⁵ – they should be better protected by Parliaments and governments.

The rules which are currently discussed in relation to economic measures involving also the professions, are influenced by an entrepreneurial and business logic. Clearly the economic dimension – which is today favoured by the severe crisis in which we are floundering – plays a central role in every decision taken, instead of being one of the evaluation criteria to be considered, on an equal footing with other equally important criteria, such as the political and legal ones.

The reasoning which is most frequently used is based on an irrefutable assumption, namely that the rules governing the professions must be “liberalized” because the current system is supposed to reduce the GDP by 1 - 1.5%.

⁵ In his essay published in *Contratto e impresa*, 2011, p. 287 seq.

This assumption taken from a Report by the Governor of the Bank of Italy dates back to 2008. We have never known how it was calculated nor on the basis of which criteria. If, by chance, it depended on companies' legal costs (which means that it was based on CEPEJ statistics) it would date back to 2006 – hence before the decree which abolished statutory fixed and minimum attorney fees. If it were true that this abolition has led to huge economic benefits for companies, that figure would be fully unreliable since outdated and technically incomplete. On the contrary, if it were a recent, complete and reliable figure, it would demonstrate that, over a period of six years, the elimination of statutory fixed and minimum attorney fees has not led to any useful result.

On their own, the professions produced a 11% share of GDP: on the basis of the economic data currently available, we cannot know whether this positive impact on the Italian economy is confirmed or whether the crisis has led to a reduction of the benefits that the professions provide to the economy (as we may suspect). I am speaking of *benefits* because in this demonization of professions, which is disseminated by all media, we tend to speak only about fees, castes, privileges and vested interests as if the professions were serving *only their own interests* and were a useless burden, a heavy chain of which we must get rid at any price.

If we look to the benefits provided by all the economic measures taken starting from August 2011, no improvement has been recorded in the field of professions. All the concessions, help and support measures have been focused on companies. How can this economic trend be interpreted? Is it an invitation to relinquish the distinction between these two sectors? Is it the sign of the creep-

ing change passing through the professional service market to reach market *tout court*? If this were the case, the experts and scholars who warn institutions and citizens against the creation of a new “material constitution” achieved by means of urgent decreeing would be right⁶.

If “liberalizing” means respecting autonomies, we cannot understand why the various packages of measures, starting from the first one, treated the professions cruelly by imposing any type of limits and constraints on them, thus inaugurating a *State-controlled and planned* approach, which seems to express a policy line fully opposed to the one publicized. Attorney fees were hit, and the maximum tariffs in particular, without understanding that by abolishing them we ended up by running counter the allegedly-pursued goal, namely savings for companies and advantages for all citizens; the set of measures taken to face the economic and financial crisis even tackled the issue of disciplinary measures and proceedings. If values play a significant role in the definition of government plans, how burdens were distributed and how interests were reconciled? It is hard to answer this question, since this spate of measures was taken without a consistent and systematic plan and without targeted and *well-weighed* measures.

This is an idea which is currently used in an excessively sparing way. *Reasonableness and proportionality* are mainstays of Community law. The legal framework which is being shaped in Italy with reference to professions is peculiar, because it is unique in Europe and runs counter to E.U. directives and the Court of Justice case-law. This was noted by the CCBE - the organization repre-

⁶ See RODOTÀ, *Diritti e libertà nella storia d'Italia. Conquista e conflitti 1861-2011*, Rome, 2011.

senting lawyers at European level, which voices the needs of all European countries including common law and Northern European countries - in a letter sent to the institutions, which passed over in silence since it was not disseminated by media. Depressing the professions with rules which standardize, rather than distinguish, the individual specificities by means of the diversifications of knowledge and practical experience, relegating them to a matter for regulatory streamlining and simplification, subduing them to the use of corporate forms typical of business activity, delegitimizing the representative bodies, which ensure compliance with ethics rules and, hence, are an outpost to protect citizens' fundamental right and interests, means implementing a set of rules which is not only not "required by Europe", but even in contrast with Community law principles.

Nevertheless, there is another reasoning that I wish to follow to justify the criticism levelled at the lawmakers and governments that tackled the issue of professions and the legal one, in particular: the reasoning based on the relationship between *authority* and *freedom*, which can be inferred from the intensity of the intervention (be it legislative or regulatory) in this sector. In spite of the freedom values invoked, the lawmaker has transferred competence from the Italian Bar Council (which is the highest expression of the autonomy and self-jurisdiction principles) to the executive power, has reshaped the attorney-client relationship, has affected the codes of ethics by defining their boundaries by subject matter and *modus operandi*, has changed the access rules by taking away their control from professional rolls and associations, has abolished some of their competence, particularly the one designed to assess the appropriate-

ness of fees. This excess of measures has reduced guarantees for citizens. The legislative measures, which have limited the professions' freedom of organization, have stricken a blow against the system based on professional rolls and associations, which is currently far different from the one conceived in the Middle Ages or during the Fascist period with the establishment of professional guilds, the so-called "*corporazioni*". History, which is the master of life, reminds us of the dissolution of professional rolls and associations imposed during the dictatorship: their organization was a shield against the government's totalitarian plans and their activity was sap and nourishment for the freedoms the government wanted to stifle. As Prof. Vincenzo Cerulli Irelli recalled us in his opening remarks on the occasion of the 7th refresher course for the legal profession held last March – it is precisely in this perspective that we must assess the impact of the rules imposed *ab externo* and authoritatively on the self-regulation and self-governing freedom which should be recognized and guaranteed to the intellectual professions, and the legal profession in particular.

This freedom has been ignored in the 2012 stability law regarding stock companies and partnerships in the organization of professional activities. In its first version the bill enabled mere stock partners to enter professionals' partnerships without any limit. Only thanks to the attention paid by Parliament to this matter was it possible – few months later – to revise at least the most inappropriate and unsuitable provisions, pending the Ministerial implementing Decree which would be issued in the short term. The draft regulation does not impose any limit to the managerial powers of non-professional partners or third parties; it does not envisage explicitly that professionals' partnerships must not

be subjected to bankruptcy procedures or that they may have access to the procedure designed to solve the problems caused by over-indebtedness. The draft regulation is also lacking from the tax viewpoint: it would have been appropriate to clarify that the income produced by professionals' partnerships are to be considered self-employment income. Furthermore it is not clarified whether the stock partner shall be an individual or also a legal person. All the inadequate and inconsistent aspects that the Italian Bar Council has reported *voluntarily* to the relevant institutions and which shall be considered in the final drafting of the regulation. In relation to another problem also raised by the Italian Bar Council, namely the registration of multi-disciplinary professional partnerships with the Bar, the draft regulation makes reference to the "prevailing activity", while no provision is envisaged with reference to the consistency between the various professional activities performed concretely by the multi-disciplinary partnership.

With reference to the ethics aspects, professionals' partnerships shall comply with the rules of the professional roll or association with which they are registered. Furthermore, "if the infringement of ethics rules perpetrated by the individual professional partner can be referred to guidelines given by the partnership, the partner's disciplinary liability adds to the partnership's". It is worth noting that it would have been appropriate to envisage also a fine for the professional partnership proportionate to the severity of the disciplinary offence perpetrated, as proposed by the Italian Bar Council.

4. The Italian Bar Council pays specific attention to the relations with the institutions: in particular, while fulfilling the tasks, institutionally falling upon it, of providing consultancy on the measures regarding the legal profession and justice (article 14, Legislative Decree no. 382/1944), the Italian Bar Council participates regularly in hearings within Parliamentary Committees related to measures of interest to it, upon the invitation of the relevant institutions and sometimes by asking expressly to be consulted.

During the period under consideration (January 2011/July 2012), the Italian Bar Council took part in 11 hearings before the Parliamentary Committees on Constitutional Affairs, Justice, Education and Productive Activities through its President, Secretary Councillor or other duly authorized Councillors. In most cases, besides the report of its President, the Italian Bar Council also submitted in-depth analyses (also levelling criticism, where appropriate) of the individual bills, prepared by the Research Office.

The particularly significant topics on which the Italian Bar Council was heard obviously included the bill AC 3900 on the legal profession reform, as well as:

- the judges' civil liability, in the framework of the fact-finding survey of the Senate Committee on Judicial Affairs, in view of the adoption of article 25 of the 2011 Community law;
- the reform of the rules to remedy and compensate the damage caused by the excessive length of trials;
- the liberalization of professional rolls and associations and the additional measures for fostering growth regarding justice administration (first and fore-

most, the creation of the Court for companies) included in Decree-Law no. 1/12 designed to boost growth (the so called Decreto “Cresci Italia”).

We could equally recall, however, consultations regarding the reform of honorary judges, shared parenting and joint custody, the streamlining and simplification of civil trial proceedings.

We hope that next hearings will tackle the thorny issue of the overhauling of the geography of areas of jurisdictions. Unfortunately, also on this matter, the lawmaker is proceeding without appropriately consulting lawyers. On May 10, 2012, the Italian Bar Council and the National Association of Italian Municipalities (ANCI) signed the Protocol of Agreement with which they expressed great concern for the possible reduction of areas of jurisdictions carried out in the lack of a detailed analysis of the total costs really borne for justice administration and in the lack of planning criteria with which expenses are calculated.

The Italian Bar Council and ANCI criticize the method followed by the government in revising the areas of jurisdictions; they maintain that also for the justice sector we must abide by the model indicated in Article 9 of Decree-Law no. 98 of July 6, 2011, namely the criterion for overcoming the historical spending and the criterion of public spending rationalization through the identification of standard costs and requirements.

The survey carried out by the Italian Bar Council on the real situation of areas of jurisdiction in Italy was submitted to the government, the Justice Minister and the relevant Parliamentary Committees.

Moreover, the Italian Bar Council and ANCI submitted a request for a joint hearing before the Parliamentary Committees on Judicial Affairs.

5. However, the limits of the counsels' rights and duties, defined by primary sources of law and codes of ethics, are based on irrenounceable autonomy and independence principles not only of individual lawyers, but also of the representative bodies which defend their powers and check their behaviours, by imposing the necessary penalties for their activity to be performed properly. Over time these principles have been turned into legal rules corroborated by ethics rules.

These principles are so widespread that they were the subject of various European Parliament's Resolutions dating back to some years ago, motivated by the fact that the E.U. Commission – filled with enthusiasm for the implementation of the competition principle with a view to stepping up the creation of the single market - could end up by mistaking the role played by counsels, and hence the services provided by lawyers, for mere provision of *services* which can be assimilated to business activities.

Among these legislative instruments, it is particularly worth recalling the European Parliament's Resolution of May 23, 2006 which highlights the counsel's role, in particular. It is worth quoting some excerpts to explain the E.U. model of justice and lawyers' role which, currently in Italy, seems to be forgotten as a result of the measures taken following the economic crisis and as a result of the prevailing economicist approach, which ends up by weakening constitutionally guaranteed rights.

First and foremost, the European Parliament reaffirmed the principles defined by the Court of Justice case-law, which are at the core of the code of ethics currently in force in our legal system, namely:

‘independence, absence of conflicts of interest and professional secrecy/confidentiality are core values of the legal profession that qualify as public-interest considerations;

regulations to protect core values are necessary for the proper practice of the legal profession, despite the inherent restrictive effects on competition that may result from this;

the purpose of the principle of freedom to provide services as applied to the legal professions is to promote the opening up of national markets through the possibility offered to service providers and their clients to benefit fully from the Community’s internal market”.

The Resolution has reaffirmed that “any reform of the legal professions has far-reaching consequences going beyond competition law into the field of freedom, security and justice and, more broadly, into the protection of the rule of law in the European Union” and also that “adequate protection of the human rights and fundamental freedoms to which all persons are entitled, be they economic, social and cultural, or civil and political, requires that all persons should have effective access to legal services provided by an independent legal profession”.

This premise is in line with our constitutional system, but it is endangered by the current rules introduced with the various stability packages of measures

designed to curb the effects of the economic crisis, as if rights could be equated with goods on the “justice market.

The Resolution also insisted on:

“the duties of legal professionals to maintain independence, to avoid conflicts of interest and to respect client confidentiality [that] are particularly endangered when they are authorised to exercise their profession in an organisation which allows non-legal professionals to exercise or share control over the affairs of the organisations by means of capital investment or otherwise, or in the case of multidisciplinary partnerships with professionals who are not bound by equivalent professional obligations”.

Also this principle has been betrayed by the recent rules authorizing the entry of mere stock partners into professionals’ partnerships and even enabling stock partners to belong to many professionals’ partnerships.

The Resolution also tackled the issue of the counsels’ appropriate remuneration “whereas unregulated price competition between legal professionals, which leads to a reduction in the quality of the service provided, operates to the detriment of consumers”. Also this principle has been infringed by internal rules and regulations, at first with the elimination of minimum rates and fees, subsequently with the elimination of maximum tariffs and finally with the elimination of any fee parameter. This is in contempt of the principles established by the European Court of Justice which, in many judgements, had legitimised the Italian system to set counsels’ fees.

Furthermore, considering the social and public relevance of the tasks performed by lawyers, the Resolution focused on the adoption and implementation

of codes of ethics, namely rules of ethics by which all lawyers practicing the legal profession must abide. The Italian code in force is very strict from two viewpoints since it obliges lawyers to defend (and never betray) their clients' interests; not to accept the assignment or forgo it when they realize they have a conflict of interest with their clients; not to accept assignments they would not be able to fulfil with diligence and care; not to increase the number of trials; to discourage their clients from initiating futile or fully groundless legal actions; to explain and draw their clients' attention to the profiles of lawfulness, fairness, appropriateness and expediency in the defensive strategy, evidence collection, etc. so as to preserve fair relations with their clients, though also claiming an independence-based relationship with them – a thesis which hence radically denies the peculiar conception by Francesco Carnelutti that –as already said – wished to assimilate the counsel to the client's *nuncius*.

In particular, the Resolution:

“recognizes fully the crucial role played by the legal professions in a democratic society to guarantee respect for fundamental rights, the rule of law and security in the application of law, both when lawyers represent and defend clients in court and when they are giving their clients legal advice;

reaffirms the importance of rules which are necessary to ensure the independence, competence, integrity and responsibility of members of the legal professions so as to guarantee the quality of their services, to the benefit of their clients and society in general, and in order to safeguard the public interest;

reminds the Commission that the aims of the rules governing legal services are the protection of the general public, the guaranteeing of the right of de-

fence and access to justice, and security in the application of the law, and that for these reasons they cannot be tailored to the degree of sophistication of the client”.

The Bar code of ethics devotes a full chapter, namely the third one, to the attorney-client relationship. Nevertheless, before focusing on the specific rules governing this relationship, it is worth recalling the codification of the duty of loyalty (article 7), diligence (professional diligence: article 8), professional secrecy and confidentiality (article 9), independence (article 10); the duty of defence when required by law (article 11); the ban of conflict of interest (article 12); the duty of truth which prevents lawyers from lying in courts and fiddle with evidence (article 14); there are also other minor duties (of information, etc.), but the previously mentioned trust-based relationship, the ban of conflict of interest and the non-fulfilment and breach of contract are specifically envisaged.

These principles defined in 1997 by the Italian Bar Council have been gradually adjusted to the needs emerging from the practice, namely in the framework of the jurisdictional activity carried out by the Italian Bar Council, and also considering the national lawmaker’s impositions, particularly in accordance with Decree-Law no. 223/2006, inspired by anti-competition rules and regulations. The limits imposed on lawyers to the competition benefit do not always seem to be in line with the above stated Resolution and the Court of Justice case-law.

The persistent reference to this Resolution is due to the fact that the principles it enshrines are shared by the whole European legal profession and are a guarantee of protection for citizens.

Nevertheless, the issue does not only lie in citizens' rights, but also in assessing how they can be protected concretely and be turned from solemn declarations of principles enshrined in constitutional or Community instruments into rights experienced in the court daily practice. Citizens' rights are protected if the rights of lawyers, who must have the power to defend citizens before any judge or court, are safeguarded. This is exactly the Protocol of Agreement of all European legal professions, entitled "*Avocats dans le monde*" and signed in Paris some years ago, which wished to support the cause of fundamental rights before judges all over the world, precisely by virtue of the privilege connected with the practice of the legal profession.

Hence, it is significant to combine the principles ensuring access to justice and "fair" trials with the principles ensuring judges' and the legal profession's independence and autonomy. These principles are limited by any legislative or regulatory measure entrusting to external bodies (such as the Justice Ministry) the drafting of rules to organize the legal profession (which, being an "intermediate community" has the right to freely organize itself, outside any legislative intervention), or even interfere with the ethics principles or trial rules, the implementation of which is entrusted to local rolls and associations and the Italian Bar Council. Currently the Ministerial plans to reform the legal profession tend to disregard the fact that the ethics principles set by the Italian Bar Council are recognized as primary rules by the Supreme Court of Cassation and that the Constitutional Court's decisions recognizes to the Italian Bar Council the status of special judge on an equal footing with the other judges of higher instance courts.

In conclusion, the counsels' roles and functions are steadily evolving and we cannot say that this evolutionary process is always designed to a better application of the fundamental principles recognized and guaranteed by the Constitution and the European Charter of Fundamental Rights of the European Union. It is up to lawyers *in primis*, to doctrine and judges to enable lawyers, who are the most authoritative and useful aides of judges in the performance of the jurisdictional tasks, to keep on carrying out their *functions* with the competence, fairness, autonomy and independence which are essential to ensure counsels' rights and for lawyers to abide by the law and follow their conscience – as Pietro Calamandrei used to say – without caring about anything else. This means with the courage that the legal profession requires and the Bar provides to them and also with the protection of the institutions and associations representing the legal profession such as the Italian Bar Council.