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LAW AND ECONOMICS YEARLY REVIEW

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

Editors

F. CAPRIGLIONE – R. M. LASTRA – R. MCCORMICK
C. PAULUS – L. REICHLIN – M. SAKURAMOTO

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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.

Address

Fondazione Gerardo Capriglione Onlus

c/o Centre for Commercial Law

Studies Queen Mary, University of

London 67-69 Lincoln's Inn Fields

London, WC2A 3JB

United Kingdom

Main Contact

Fondazione G. Capriglione Onlus - fondazionecapriglione@luiss.it

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FOCUS ON GLOBAL PERSPECTIVES

PRESENTATION

1. The events that have characterized the life of the EU in the last year will leave an unavoidable mark in the history of the 'Old Continent'. The complex issue of 'migrations' – and, in particular, the rise of deep disagreements on the implementation of a necessary 'immigration policy' – together with certain other issues including a generalized aversion to *austerity* measures required by some Member States (regardless of the difficult situation in which others are) and the lack of a *flexible* management of the well-known crisis of 2007 and subsequent years, identify the reasons for a widespread discontent that now pervades a large part of the European Union.

Therefore, some concerns arise about the strength of the socio-political fundaments at the basis of a unified infra-state system, which has been launched more than half a century ago by some Countries that at the time believed in the possibility to create an aggregation aimed at evolving over time, through a 'small steps' policy, from an initial *economic community* towards a *political federal structure*. Such concerns have found their easy landing place in 'populist movements', now disseminated in many European Countries, and, more generally, in the success of ideologies focused on the revival of national frameworks for the purpose of terminating a system of forced cohesion considered in contrast with the interests of any individual member of the Union.

In this context, characterized by a progressive weakening of the will (or rather: the spirit) which should animate and support relations among the EU Member States, we have recently seen the traumatic event of *Brexit*. The latter led to an historic *shift* in the European institutional framework, which leads to a wide-ranging discussion, not limited to the socio-economic consequences of such event.

Hence the necessary references to the possible negative implications for the UK of the referendum vote of last June 23rd. In this regard, shall be considered both the deep reasons that may have convinced the British people of such a significant choice, and the identification of the 'costs' of a transition probably intended to affect the UK permanence in the 'common market', with the obvious consequence of determining a possible weakening of the leading role it played in the international 'finance'. From another perspective, it becomes also relevant the analysis of the impact of the 'leave' on the imbalance caused in the EU area, threatened by the danger of adverse economic and financial consequences borne only by certain Countries and by the fear of possible forms of *contagion* concerning the tool of referendum, all able to empower the anti-European spirit diffused in large part of the Union. At the same time, the delays that are characterizing the beginning by the UK of the procedure, provided by the European treaties, aimed at allowing the leave, become also cause of concern, showing the need of a joint effort by all the Member States in promoting the 'sense of responsibility' of Britain to give prompt execution to vote democratically expressed by its citizens.

2. In light of the above, the editorial board of this Review has considered appropriate to dedicate the general part of this issue to the analysis of certain aspects of the topic abovementioned. Such decision has been influenced by the opinion that a research of suitable solutions aimed at intensifying the cooperation among Member States which could relaunch an EU growth program needs, at the basis, contributions aimed at clarifying the effects of Brexit and the ways of its implementation.

To these research perspective – in order to identify new paths for an integration which develops and strengthens harmony within the Union, while maintaining meaningful relationships with Great Britain – some specific surveys have been included, pertaining specific profiles of the European regulation and which denote particular systemic importance also in the perspective of their uniform implementation in the European regional context. The reference to a regulation which is consistent with the indications of the Member States must be considered, in fact, as an aid in deepening the different regulatory approach that distinguishes the complex regulation at hand with respect to disciplinary models adopted in the UK after the financial crisis started in 2007; an investigation that it appears essential if we consider a renewed system of economic and financial relations among the State entities involved.

Francesco Capriglione

Editor-in-Chief

BREXIT: AN ANTI-HISTORICAL DIVORCE WHICH CAN CHANGE THE EU

Francesco Capriglione *

ABSTRACT: *Moving from an historical background of the relationship between UK and EU, this Article provides a careful analysis of the vote expressed in Great Britain on June 23rd, 2016, showing that such referendum reflects the typical logic of the British population, which is characterized by a pragmatic vision of social relations, where own interests are preferred when it comes to decide how to act.*

Then this analysis explains why the British population decided to "divorce" examining a series of mistaken political evaluations starting from the referendum vote decided by the Greek Premier Tsipras in June 2015.

Furthermore, this Article faces the issues arising from a sudden application of Art. 50 of the TEU in this context, arguing that a postponement of the UK withdrawal is not acceptable for the entire EU since further procedural delays must be avoided in order to stop the protracted situation of post-Brexit uncertainty and the EU exposure to economic and financial imbalances and to raising populist political movements that are trying to emulate the UK case.

This paper lastly analyzes the impact of the Brexit vote on the entire EU, showing the limits of the current structure of the Union, incapable of succeeding in promptly finding within itself the solutions required to overcome the moment of serious difficulties which it faces as a result of the referendum vote. In light of the above, this Article concludes stating that an intelligent handling of the phase subsequent to the Brexit cannot refrain from dealing with a joint effort of all the Member States in confirming, with a sense of responsibility, the commitment undertaken with the adhesion to the Treaties. The search for new paths towards the

* Full Professor of Law and Economics and Dean of Law Faculty at *Università degli Studi Guglielmo Marconi* in Rome.

integration identifies in actual terms the most appropriate way to make sure that the damage caused by the Brexit does not reach so high a level as to shatter the «European dream» in which, ultimately, the vast majority of the people of the Union, including the young generation of the United Kingdom, continue to believe in.

1. In the middle of a storm, it is always difficult, when not impossible, to reflect on the effects that could arise from it; in fact, one is often caught between different feelings, from fear to gasping research of possible reactions that could offer the chance of overcoming the negative impact that seems to overwhelm everything and everybody.

Many European citizens, on the last June 24th, faced the shocking news of the success of "leave" in U.K. with such state of mind. This event, unintelligible according to many, led to a feeling of great sadness that was then overcome by the desire of understanding the reasons that guided the British into such a traumatic choice, not only for them but for the entire European Union; a choice that has, suddenly, erased a decades-long political and socio-economic relationship between Great Britain and European Union and, at the same time, has challenged EU's grounds. The astonishment – together with the respect for a decision taken with a democratic method – became concern, for a future full of uncertainties; hence, the opinion of many economists and political analysts, which defined "not so forward-looking" the option for the *Brexit*, decided by the 52% of the British and welcomed with enthusiasm by the populistic and extremist European groups.

After the referendum vote several Authors have attempted to resolve the questions posed by a vote result as surprising as unequivocal in its pervasive and unfailing impact of its effects with regards to the *irreversibility* of the UK's exit from EU.[1] The results of these researches – even contributing significantly to the clarification of the reasons at the base of a political choice so significant and, especially, to the identification of the modalities of the withdrawing procedure pursuant to Article 50 of the TEU (applicable in this case) – keep open wide margins to the reflection concerning the specificity of the consequences of Brexit in the European financial framework. It is in this direction, therefore, in perspective, that the analysis which are aimed at verifying if this events are the consequences of faulty operations and inappropriate calculations of the current leadership of the UK or if they represent the culmination of the lack of spirit of accession of Great Britain to the EU, growing from time to time and actually freely expressed, shall be oriented.

The *referendum*'s results show a country clearly divided – due to the enormous socio-cultural gap underlined by the polarization of the electoral outcomes – and characterized by the separatist movements of Scotland and Northern Ireland;[2] in this context appears unreal that London, one of the most international and inclusive cities of the world, has been excluded from the Union project.[3] At the same time, from these results appears a European reality marked by an unavoidable realization of the limits of the "new-functionalism", suggested by Jean Monnet (according to which the economic integration would have led also to political integra-

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[1]See, among others, CURTI GIALDINO, *Oltre la Brexit: brevi note sulle implicazioni giuridiche e politiche per il futuro prossimo dell'Unione europea*, consultable on *federalismi.it,* June 2016; SAVASTANO, *Brexit: un'analisi del voto*, *ibidem*, June 29, 2016; CARAVITA, *Brexit: Keep calm and apply the European Constitution*, consultable on *federalismi.it* of June 29, 2016; PRIMO DI NICOLA, *La Brexit non vincolante. Il documento choc che può bloccare il referendum*, consultable on *www.tiscali.it*, June 28, 2016; ZINGALES, *The Real Lesson From Brexit*, on *Pro Market*, University of Chicago, *Booth School of business*, June 29 2016; TOSATO, *Brexit. Dal referendum al recesso*, on apertacontrada.it, June 30 2016); GILES - TETLOW - CADMAN, *Brexit barometer: economic mood darkens*, in *Financial Times*, 21st July 2016; PELLEGRINI, *Thoughts on Brexit and first evaluations on the results*, available on *Open Review of Management, Banking and Finance*, August 30, 2016.

[2]See, among others, the editorial *EU referendum: full results and analysis*, published by *The Guardian* and available on *www.theguardian.com/politics/ng-interactive/2016/jun/23/eu-referendum-live-results-and-analysis.*

[3]See the editorial of DEMURTAS, *Brexit, gli scenari con Londra che lascia l'Unione europea* available on *www.lettera43.it/politica/brexit-gli-scenari-se-londra-lascia-l-unione-europea.*

tion);[4] realization that regards also the failure of the comitology committees mechanism, based on an intergovernmental criterion, basically designed in order to guarantee the continuity (and not the overcome) of national individualisms, thus the failed achievement of satisfactory ways of convergence.[5]

This is the discouraging evaluation arising from the British vote of June 23rd, 2016! Together with this feeling, there is also an undeniable destabilizing effect that regards, first, the economic and financial reality of United Kingdom. In fact, British electors were so focused on recovering, with said *referendum*, an independence perceived as fundamental (especially for people over 60 years old) that they did not evaluate the negative effects that would have arisen in any case (*i.e.* effect on the import/export levels and consequent decrease of the GDP, risk of downgrade of debt outlook released from the rating agencies, redrafting of London financial stock, foreseeable price increases, decreased interest for English universities). A similar unbalanced situation can be found in the EU area, threaten not only by the risk of negative economic and financial consequences towards some countries, but also by the menace of a domino effect of the aforementioned *referendum* activities in other Member States;[6] hence, the probable beginning of a process that could end, reasonably, with the implosion of the EU.

Looking at how every financial market, in every single country of the world,

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[4]Please remember that in the years immediately following the World War II – against the difficulties of pooling national policies on *federal-constituent* vision, outlined by Ernesto Rossi and Altiero Spinelli in the famous essay entitled *Manifesto di Ventotene* (1944), or on that *confederal* supported by Winston Churchill (see in this regard VASSALLO, *Tra Winston Churchill e Hendrik Brugmans. Federalisti e unionisti nella grande assise del dopoguerra*, in *Eurostudium*, January-March 2010, 8 ss.), both related to the creation of a new political organization – it prevails the method followed by Jean Monnet, inspired at Mitrany's «functionalism» (see *A working peace system*, London, 1943) and at Haas' neo-functionalism (see *The Uniting of Europe – Political, Social and economic Forces, 1950-1957*, London, 1958; Id. *Beyond the Nation State*, London, 1964) and Lindberg's neo-functionalism (see *The Political Dynamics of European Economic Integration*, London 1963).

[5]Meaningful, regarding this point, SAVINO, *La comitologia dopo Lisbona: alla ricerca dell'equilibrio perduto*, available on *Giornale di diritto amministrativo*, 2011, 1041, in which the comitologic mechanism is defined «heritage on an institutional balance, that is anachronistically unbalanced in an intergovernmental way».

[6]See, among others, the publishing *Effetto Brexit, Le Pen:"Uscire dall'Unione europea ora è possibile",* available on *www.rainews.it/dl/rainews/articoli/Brexit-Le-Pen-Uscire-da-Ue-ora-possibile.*

has reacted to the electoral result (giving rise to the "black Friday" of the Pound and to a frenetic loss in the western and eastern stock exchanges), it is easy to understand how the aforementioned results had, initially, a traumatic impact on the international community, letting also foresee the complexity of a period of assessment that will probably not come to an end in the next future.[7]

Under another point of view, the copious initiatives organized by the *Remain* front that took place in the United Kingdom before the *referendum* (*i.e.* petition for the proposition of a new popular consultation, request for the secession of the capital city, announcement of the Scottish Premier of immediate procedures and discussions with Brussels in order to "protect Scotland's place in the EU", and so on)[8] – are showing the inevitable difficulties that are connected to a change so important under an institutional point of view, that would have had required a generalized consensus from the British population.

2. In a recent analysis on the reasons behind the current stagnation of the original project of the European Community's founding fathers, I clarified the Great Britain's peculiar position. The latter, in fact, has to be included in the group of Member States that, more than others, determined the conditions for a review of the "political project" of a "free and united Europe", designed by Altiero Spinelli and Ernesto Rossi in order to fight against the totalitarianism that reigned during II World War in the "Old Europe".[9] This conclusion seemed consistent with a Country that, without participating in the starting phase of the European Union "at six", finalized only in 1973 the negotiation for entering into the "common market".[10]

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[7]See, among others, BALESTRERI, *E' Brexit: sterlina in caduta libera, Borse a picco. Piazza Affari mai così male: -12,5%*, published on June 24th, 2016 and available on *www.repubblica.It/ economia/2016/06/24/news/ brexit_borse_a_picco_e_sterlina_in_caduta_libera.*

[8]See *Brexit, le contromosse dei pro Remain: petizioni per ripetere il referendum e Scozia chiede (di nuovo) indipendenza*, available on *www.ilfattoquotidiano.it/2016/06/25/brexit-le-contromosse-dei-pro-remain-petizione-per-ripetere-il-referendum-e-scozia-chiede-di-nuovo-indipendenza.*

[9]See CAPRIGLIONE – SACCO GINEVRI, *Politics and Finance in the European Union. The Reasons for a Difficult Encounter*, Wolter Kluver, 2016, p. 209 ss.

[10]See PARR, *Britain's Policy Towards the European Community. Harold Wilson and Britain's World Role, 1964-1967*, London, 2005; Toomey, *Harold Wilson's EEC: application: inside the Foreign Office 1964-7*, University College Dublin Press, 2007.

In order to fully evaluate the role of United Kingdom inside EU, it has to be kept in mind that said country, for its cultural features and for its attitude in defining European policies, often showed a sort of detachment in regards to the other part of the continent or, more precisely, often was not willing to be fully included in the European reality, maybe perceived distant and not as fundamental as the domestic one. Notwithstanding the above, the United Kingdom in the aftermath of II World War was one of the first European countries that understood the importance of creating a supranational constituent, in order to start an integration process between States.[11]

The long and animate debate, that took place in Great Britain in the second half of the XX century (especially the activity carried out by the Tory Harold MacMillan and by the Labour Harold Wilson) regarding the adhesion to the European project,[12] ended in 1973 with Great Britain's admission to the European Community, demonstrates that the United Kingdom did not choose to enter, via a *referendum,* into the aforementioned Community with a spirit of political integration. In fact, there was never a full bias for a complete participation, while there has always been a strong interest for benefiting from the communitarian mechanisms based on inter-governmental methods.[13] A traditional attachment to the national sovereignty, in all its various forms, is at the base of a policy that, even if understandable under the economic improvement point of view (exports, employment rates etc.), is not consistent with the fierce oppositions often raised in said Country against the European policies.

In this regard, are meaningful the disapproval expressed by several important political representatives already in the seventies, like Sir Teddy Taylor who resigned from his position as Ministry of the Government as soon as he acknowl-

[11]See *Churchill Commemoration 1996. Europe Fifty Years on: Constitutional, Economic and Political Aspects*, published by Thürer and Jennings, Zürich, Europa Institut-Wilton Park, Schultess Polygraphischer Verlag, 1997.
[12]See TOOMEY, *Harold Wilson's EEC application: inside the Foreign Office 1964-7*, University College Dublin Press, 2007.
[13]See, among others, CHARTER, *Au Revoir, Europe: What If Britain Left The EU?*, London, 2012.

edged that the United Kingdom had signed the Treaties of Rome.[14]

In such a contest, we can place both Great Britain's failed adhesion to the "single European currency" and its policy towards European affairs, focused, since 1992 (*i.e.* since the Maastricht Treaty) on protecting national interests. It is easy, then, to find an explanation for the frequent requests of regulatory adjustments (*rectius* changes) and for stances not consistent with the aim of total communion, useful instead in order to reach a complete integration (where the common interest has to prevail on the individual one of each Member State). In literature, in fact, the analysis of the aforementioned reality led to evaluations that refers both to British government acting as a "gate keeper" towards European community, both to an evident Great Britain's detachment from the European project.[15] These evaluations have been lately summarized by an interview of Jean-Claude Juncker, with German public channel Ard, where he stated that "the divorce between EU and United Kingdom will not be a consensual one, but it was not a great love story either".

The agreements signed in Brussels on February 2016 between Prime Minister David Cameron and European summit, granting to Great Britain a peculiar *status* among the EU, have to be read taking into consideration what mentioned above. Amid these concessions, there is not only the symbolic affirmation the UK will never be part of "always tighter" Union, but also several facilitations (specific importance has to be given to the one that grants the possibility for the UK to reduce state subsidy for European immigrants). These agreements are the consequence of EU's difficulties in facing the economic convenience reasons that have been placed by United Kingdom at the base of its adhesion and participation to the Community Founding Fathers' project. Hence, it can be affirmed that UK's decisional policy has been driven by utilitarian considerations and not by solidarity

[14]See CACOPARDI and others, *Ingresso del Regno Unito nella CEE. La Gran Bretagna nella CEE/UE*, available on *www.geocities.ws/osservatore_europe/approfondimenti/semi07.htm.*

[15]See, among others, GEORGE, *Britain and the European Community: The Politics of Semi-Detachment*, Oxford, Clarendon Press, 1992; MORAVCSIK, *Preferences and power in the European Community: a liberal intergovernmentalist approach*, available on *Journal of Common Market Studies*, 1993, n. 4, p. 473 ss.

and cohesion, as it should have been for Member States.

3. A careful analysis of the vote expressed in Great Britain on June 23rd, 2016 lead to affirm that said vote reflects the typical logic of the British population, which is characterized by a pragmatic vision of social relations, where own interests are preferred when it comes to decide how to act. This peculiar way of conceiving how to relate with other individuals can be summarized by an interview given by Margaret Thatcher to Women' Own Magazine on October 1978.[16] The former Premier, when asked on how the Government should have dealt with social issues, replied "no Government can do anything except through people, and people must look to themselves first. It's our duty to look after ourselves and, then, also to look after our neighbour". This statement contains the principle that characterized the way the UK builds relations with other countries, also with its European partners, since 1973!

«People must look to themselves first». Attention to its own interests identifies the main object of the British government, leading to an exhausting research for economic convenience in the relations with its own neighbour; hence, the mandatory limitation of any sort of openness towards other countries in order to create relations based on cohesion and solidarity. The abovementioned resulted in UK's policy in the course of time; said policy, in fact, reflects an anti-European attitude that, in the present, has been revealed by the referendum vote, which showed the real nature of Great Britain, with obvious astonishment for all those people who considered UK a real European country.

In such a contest, it is easy, on the one hand, to explain not only the aforementioned rejection towards the "single European currency", but also the one towards the "Banking Union" project and the lacking adhesion to Fiscal Compact and Schengen Agreement (subject to the opt-out clause in relation to the free movement of persons). On the other hand, it is also easy to understand that Euro-

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[16]See THATCHER, *Interview* for *Woman's Own* ("*no such thing as society*") September 23rd, 1987.

pean Union has been mistaken in granting all these concessions to United Kingdom, especially those granted with the already mentioned February 2016 agreements, that resulted in a special status for the UK. It is clear that the EU's yielding policy towards Great Britain requests was not enough for keeping the latter in the European Union, as it did not prevent the British population from ending a relation perceived (maybe suffered) as a form of "forced coexistence"!

Considered this, we are still wondering why the British population, notwithstanding a permanent privileged treatment, decided to "divorce" from the European Union, terminating a relation that was, according to many, unbearable. The answer to this question has its origin in a series of mistaken political evaluations, starting from the referendum vote decided by the Greek Premier Tsipras in June 2015.[17]

Reference is made especially in relation to Cameron's campaign in 2013, during which he promised, in order to obtain Tory's endorsement for a second mandate, the Brexit referendum, without taking into consideration the real chances of the Remain's victory. It is obvious how, in that occasion, Cameron has been led by superficiality and insufficient evaluation of negative consequences of a Brexit referendum. Cameron "as a year ago Alexis Tsipras … considered the referendum vote as an *escamotage* from a situation in which he felt trapped".[18] Thus, said incautious politician, facing the threat of losing his position as leader of the Conservative Party and candidate Premier, "decided to put on the green table United Kingdom's destiny", speculating, at the same time, about being able of "silencing Ukip's ultra-nationalists".[19]

This "strategic move" is consistent under a juridical point of view, as asking for population's vote is compliant with the decisional process recognized in mod-

[17]See CAPRIGLIONE, *Grecia: una tragedia del nuovo millennio*, available on *Apertacontrada*, July 23rd, 2015, par. 3; FERRARI, *Grecia, l'audacia di Tsipras,* published on *Corriere della sera* July 11th, 2015 and available on *www.corriere.it /economia /15_luglio_11/grecia-l-audacia-tsipras.*
[18]See FUBINI, *Brexit, La scossa che ha cambiato l'Europa,* available on *www.corriere.it/esteri /16_giugno_24/brexit-scossa-che-ha-cambiato-europa.*
[19]See FUBINI, *Brexit, la scossa che ha cambiato l'Europa,* cit.

ern democratic systems.

Notwithstanding this, if on the one hand this move's meritorious aim is to let the "national sovereignty" prevail over the European regulatory logic, on the other hand, in terms of substance, it seems that this move has been used for improper purposes and without taking on the responsibilities that such a situation would have required.

Consequently, in order to understand the main cause of the aforementioned events, it has to be considered Cameron's intent of avoiding a reduction of his favourable electorate and the relevant consequences upon the stability of his Government. This analysis is furthermore sustained not only by the critical judgements received by the specialized press,[20] but also by Cameron's inconsistent behaviour after the victory of "leave", as he tried to minimize the electoral outcome and postpone the finalization of the exit procedure (without acknowledging his own responsibilities in relation to the inevitable issues arising from his conduct).[21]

4. In consideration of the number of facilitations that the EU had granted to Britain, it might have been reasonably supposed that the outcome of the referendum would have confirmed the *status quo*. Hence, several observers had regarded as likely an election result that would have substantially monetised the 'net overall benefit' of keeping the UK inside the Union.

In fact, the history of that country, along with its relational behaviour towards the EU, made possible to imagine that a 'choice' based on an *economic rationality* – which in Britain seems to act in a self-referential key, as the unique paradigm to regulate civil coexistence – would have prevailed. Such a choice – if based on the comparison between possible economic and financial benefits aris-

[20]See PELOSI, *Monti critica Cameron sul referendum*, available on *www.ilsole24ore.com/art/notizie/2016-06-18/brexit-monti-cosi-cameron-distrugge-ue-105741.shtml?uuid=ADnQ2Ze*.

[21]See *Brexit/ Referendum Unione Europea, Cameron, Il risultato va accettato, restiamo uniti*, available on *www.ilsussidiario.net/News/Politica/2016/6/27/Brexit-Referendum-Inghilterra-Unione-Europea-il-trucco-di-cameron-e-bufera-in-Ue-conseguenze-Gran-Bretagna-27-giugno-2016*.

ing from a potential exit of the United Kingdom from the Union,[22] on the one hand, and, conversely, the negative implications that could have been found in the balance on current account and in movements of capital, in the stock, bond and real estate British markets, and in the pound sterling, on the other hand – should have brought to appreciate the cost-effectiveness of joining the EU, once checked those quantitative data that would have allowed to motivate such a continuation. In other terms, one could have supposed that the option between 'in' and 'out', under a methodological point of view, would have made the political exponents of the United Kingdom engage in a sort of microeconomic calculation involving costs and benefits,[23] in line with market principles (thus, merely instrumental to achieve an efficient allocation of available resources).

Moreover, it is clear how substantially rigid is the application of the assessment criterion which is concerned; as for the decisions regarding the relations between EU countries, recurring to such a criterion often tends to exclude the viability of a concerted action of member States, regarding it as the premise of a *suboptimal* equilibrium. In case, this action would be inspired by principles of solidarity – for instance, the one which is required to solve the problem of abovementioned migrations – if the cost of this action were estimated to be higher than the benefits deriving from the continuity of the participation to the European Union.[24]

Under this point of view, the opportunity of keeping unchanged the ad-

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On this topic see, among others, SEN, *The Discipline of Cost-Benefit Analysis*, in *Journal of Legal Studies*, 2000, 931-952; CAGLIOZZI, *Lezioni di politica economica*, Naples, 2001; CAMPBELL – BROWN, *Benefit-Cost Analysis. Financial and Economic Appraisal using Spreadsheets*, Cambridge, 2003; ADLER – POSNER, *New Foundations of Cost-Benefit Analysis*, Cambridge, 2006; BOARDMAN *et al.*, *Cost-Benefit Analysis: Concepts And Practice*, New Jersey, 2011; SINDEN, *Formality And Informality In Cost-Benefit Analysis*, available on *Utah Law Review*, 2015, p. 93-172.

[23]On this topic it has to be reminded that some academics (see CAMPOS and CORICELLI, *Some unpleasant Brexit econometrics*, available on *www.voxeu.org/article/some-unpleasant-brexit-eco nometrics*), had underlined that whatever the «*in-or-out referendum*»'s result, the relationship between UK an EU would be substantially changed.

[24]Regarding the *trade-off between efficiency and equity that leads to second-best solutions*, see the classic LIPSEY-LANCASTER, *The Genarel Theory of Second Best*, in *Review of Economic Studies*, n. 24, 1956.

vantages descending from the participation into the EU was likely to prevail. This, notwithstanding any possible negative implications of such a decision, which was perceived (*rectius*: undergone) with growing dissatisfaction in the United Kingdom, for this country was unwilling to accept some external conditioning that many felt as a threat to the preservation of the high level of welfare that had been reached (with plain consequences on internal socio-economic equilibria).

In this frame of mind, some time ago I expressed the conviction that the *referendum* would have resulted in a choice in favour of *Remain*, clearly referable to *neutral* considerations.[25] And it is evident how, in light of the recent outcome of the electoral consultation, these considerations have turned out to be not very useful in order to focus the complex reality under observation, highlighting the inadequacy of the above-mentioned criterion with regard to the definition of socio-political issues. Nevertheless, it has been well understood that the positive application of such a method – by those countries that are willing to use it in case of complex economic circumstances, in which they need synthetic processes of various and numerous factors – will not be able to get around a correlation between the assessments to be put in place and the general objectives to be pursued, to whom public measures must be oriented.[26] At the same time, we should consider that voting is often biased by *emotional factors* which might not meet those expectations descending from economic analysis and political negotiation.[27]

My opinion was confirmed by the reference of the economic conditions of this way-out, regarded by analysts and distinguished economists as less significant for the Union than they could have been for Britain (taking into account both the overall amount of exports towards that country and the intrinsic difficulty to compute the negative spillovers of such a change, that would have impacted on the fi-

[25]See CAPRIGLIONE, *The UK Referendum and Brexit Hypothesis (The Way Out Perspective and the Convenience to 'Remain United'),* on *Open Review of Management, Banking and Finance*, March 2016.

[26]On this topic see ADLER, *Well-Being and Fair Distribution: Beyond Cost-Benefit Analysis*, Oxford, 2012.

[27]See MOAVERO MILANESI, *Brexit, più dei numeri contano le emozioni*, published on *il Corriere della Sera*, June 17th, 2016.

nancial operation in the United Kingdom).[28] Having said this, I also underlined that applying the cost-benefit principle could have resulted in a «shortsighted and restrictive microeconomic view», little focused on assessing interests other than those, but still relating to the measures to be taken (fatally bound to be omitted, whenever the objective of a common well-being is neglected).[29]

In conclusion, it could be argued that the *referendum* has taken place in a frame characterised by both interest and emotionalism, the latter not seemingly referable to the *pluralistic dialectic* on which a political debate aimed at seeking the forms of an optimal democratic coexistence should be based. Conversely, in this case, we would have needed to establish such a dialectic in order to achieve those solutions that, while satisfying the United Kingdom's utilitarian demands, could have strengthened the ties between that country and the Union, in line with an involvement bound to result at least in a greater cohesion.

5. In the light of the above, it is necessary to ask questions on what is really happened and how we could explain the abandonment of a behaviour consistent with the *ratio*that, time after time, had shaped the relations between Britain and the European Union. These are the questions to which plain and easily acceptable answers cannot be provided; especially as regards the aftermath of Brexit that is

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[28]The analysts calculated a certain decrease in the efficiency of the City of London, should the referendum had been approved the *Brexit*, that would have definitely determined the transfer of many activities to other Euro area's squares. On this topic see the editorial published by *Milano Finanza* on February 24th, 2016 entitled *L'impatto della Brexit in cinque punti*, available on *www. milanofinanza.it/news/l-impatto-della-brexit-in-cinque-punti*. According to this opinion has stated also Krugman; see the interview of HAAS e TOST entitled «*PAUL KRUGMAN: What's going on in China right now scares*», available on *http://uk.businessinsider.com/paul-krugman-interview-china-greece-brexit-2016*, in which at the question «Turning to Europe, what do you think about Brexit?» the unequivocal answer is: «For Britain to be pulling out of that is a bad thing economically».
An opposite opinion has been expressed by Stigliz, in an event organized by the Labour Shadow Chancellor John McDonnell; see *Brexit better for Britain than toxic TTIP, says Joseph Stiglitz*, available on *www.rt.com/uk/334409-brexit-ttip-stiglitz-eu/*, where is expressed the clarification of the economist «I think that the strictures imposed by TTIP would be sufficiently averse to the functioning of government that it would make me think over again about whether membership of the EU was a good idea».
[29]See CAPRIGLIONE, *The UK Referendum and Brexit Hypothesis (The Way Out Perspective and the Convenience to 'Remain United')*, cit., par. 4.

taking place in the UK, where – under the emotional impulse of a change full of uncertainties, bound to deny the hopes of many young people, already inspired by a convincing European spirit – there are various proposals aimed at withdrawing the outcome of an election that large sectors of population still refuse.

Analysing upcoming times will clarify the reasons of a decision bringing bitterness and concern; anyway, it is already clear that *emotions* – the ones of a nation willing to say "no" to the integration with continental countries – have prevailed over culture and rationality. British *countryside* – little aware of the real dimension of the ongoing process of Europeanisation[30] – has given latitude to a nationalistic spiral, taking advance from the consensus of a large part of the over-60 electorate, which is based on nostalgic memoirs of an unrepeatable history. To this fact, one should add the effects of an appeal to independence that – contrasting the literal meaning of that term – expresses, in particular, an intolerance towards the provisions set by the EU, along with the lack of solidarity and sharing towards the *other* Europe. Thus, centres of academic excellence – such as Oxford, Cambridge, and others – have been forced to give way to a sort of rebellion among lower-middle classes, which – feeling themselves marginalised – have intended to remove in this way the reasons of their discontent.

Thus, one could retrieve different behaviours between the British economic *élite* – which is very likely to have limited its cost-benefit analysis – showing an orientation to remain inside the EU (for instance, it is significant the attitude of the finance world, sided with *Remain*), along with intellectuals and universities (strongly oriented toward supranational openness) on the one hand, and the rest of population (moved by other – nationalistic and xenophobic – issues), that have pushed for *Leave*, on the other. This one, reckless of the economic price to be paid, has substantially seemed to be worried about the problem of *migrations* (not only from outside the EU), perceived as a sort of 'foreign invasion', and to be-

[30]As can be inferred, considering the many researches on "what the EU is" made on Google after the referendum, see *www.repubblica.it/tecnologia/2016/06/24/news/brexit_dopo_i_risultati_in_uk_e_boom_di_ricerche_su_google_checos_e_l_ue*).

come a victim of the deceptive promises of those politicians who took advantage of disinformation.[31] Hence, the surge of a dismal reality in which there is no space for the Europeanistic spirit that, instead, could have led – among British population – the choice whether to remain or not inside the EU.

We are then facing an option that neglects (*rectius*: forgets) the advantages – not only in economic terms – gained from the Union. Besides, the United Kingdom has not taken into account the long period of time characterised by peace, made possible by the EU for peoples that had been fighting one another along centuries. We may see in their entirety all those limits – descending from the insular characterisation of Britain – that has never signalled, more than today, a *separateness* that perhaps we should have overcome, even by disregarding Churchill's notable remarks: «Every time we have to decide between Europe and the open sea, it is always the open sea we shall choose».[32]It is not a coincidence that, in the aftermath of the *referendum*, it has been underlined how – albeit «the pragmatism showed by Churchill and his generation's leaders» would have to be considered inevitably lost – British electors' choice was based on reasons both rational and irrational at the same time, as a sort of mixing between a pragmatic evaluation of convenience and a visceral reaction.[33]

In this context, the deep roots of the recent British vote should perhaps come from the effects of a process of economic internationalization that has caused a significant re-allocation of manufacturing centers in non-European countries, hence leading to the depletion of some industrial cities and lowering the living standards of unskilled British workers.[34] Hence the fear of further economic

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[31]See *Brexit, Farage fa marcia indietro: 350 mln di sterline dell'Ue non andranno più alla sanità pubblica*,available on *www.tgcom24.mediaset.it/mondo/brexit-farage-fa-marcia-indietro-350-mln-di-sterline-dell-ue-non-andranno-piu-alla-sanita-pubblica*, in which is clarified that "the undisputed winner of the divorce between UK and Brussels disown his strong suit: the money deposited in the EU treasurery won't be given to the citizens"**.**

[32]See BEEVOR, D-*day***:** *storia dello sbarco in Normandia*, published by Rizzoli, 2013.

[33]See MARTINETTI, *Brexit, oggi i britannici al voto fra pragmatismo e istinto*, available on *www. lastampa.it/2016/06/23/cultura/opinioni/secondo-me/brexit-oggi-i-britannici-al-votofrapragmatismo-e-istinto*.

[34]See BROWN, *Brexit, la sfida: globali ma equi*, available on *www.corriere.it/esteri/16_ giugno_29/brexit-sfida-globali-ma-equi-gordonbrown.*

negative consequences is spreading, and it is basically related to the current EU migration policies towards people fleeing from war, famine, and death threats. Surely Europe has been judged to be responsible for something in which EU is not directly involved; hence the British vote for "leave" has been turned into a vote against the European Union, especially for naïve population that is characterized by low incomes and lacking education.[35]

In this respect, the contrast between relevant national interests (related to the manifestation of the British vote) and European integrity implies the existence of a deeper cohesion among Member States, which is actually hard to reach in the current European regional context. A European context characterized by the common desire to affirm the general supranational welfare is currently taken for granted by institutional commentators; this must be considered just an on-going trend or a hypothetical assumption, given that there is no evidence of an adequate will among Member States to bear the weight of a full integration without short term political and economic national benefits.

6. The die is cast! And a sudden application of Art. 50 TEU for the British withdrawal seems to be essential for stability of European Union as a whole. It is a firm request by the European Parliament and the Council that is not justified by punitive intents, but rather by the need of preventing further financial and economic turmoil stemming from the British referendum. An unnecessary postponement of the UK withdrawal is not acceptable for the entire EU. Further procedural delays must be avoided in order to stop the protracted situation of post-Brexit uncertainty and, above all, the EU exposure to economic and financial imbalances and to raising populist political movements that are trying to emulate the UK case.

Conversely, there is a belated repentance between not only many regretful voters, but also British politicians like the resigning Premier, David Cameron, and

[35]See CLERICETTI, *La lezione del Brexit*, available on *http://sbilanciamoci.info/la-lezione-del-brexit*, in which is clarified that «*Brexit*'s victory has nothing to do with Europe and has a lot to do with equal politics in all the countries, for certainty or for compulsion, that are causing a rejection against the rulers everywhere».

Chancellor Osborne.[36] In this context, Cameron's behavior seems to be very surprising: despite his intent to protect the UK's role in common markets and the preservation of intense economic and financial relations with other Member States, he had an ambiguous attitude towards the referendum. In fact, he is delaying the withdrawal formal request (to be presented to EU) as long as he is delegating to his successor any duties related to political agreements with EU.[37]

Great Britain is actually pursuing a calm national policy aiming at mitigating the inevitable internal consequences of the referendum results and, at the same time, at taking time for the withdrawal formal request. In this respect, the real intention is to preserve – despite a generalized adverse climate of European countries – the privileges obtained from the EU. Despite Great Britain deserves help and assistance in this complicated situation, UK's behavior reminds us some famous ancient words from Cicero: «*Quousque tandem Abutere, Catilina, patien- tia Nostra? Quamdiu etiam furor iste tuus nos eludet? Quem ad finem sese effrenata iactabit audacia?*»[38] .

A responsible answer to the question that certainly most of Europe's population stands at the moment – that is what probably is the UK's exit program – can only be given by the analysis of the provisions of Art. 50 TEU, which legally governs the matter in question.[39]

Briefly, this provision entitles Member States to decide about the recession

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[36]See DYER, *Il rimorso degli elettori britannici dopo la Brexit*, available on *www.internazionale. it/opinione/gwynne-dyer/2016/07/02/brexit-elettori-conservatori-laburisti*,in which is clarified that "the majority of the conservative parliamentarian is upset by the *referendum*'s result, but this fact concerns even more who voted in favor of *Brexit*. The regret is such that, if the *referendum* would be today, the outcome would be the opposite". Also Osborne's words are characteristic: "We'll exit Union when We'll be ready … We'll activate Art. 50 when we'll be ready", see the *BREXIT/Referendum Unione Europea, Cameron: "Il risultato va accettato, restiamo uniti" (conseguenze Gran Bretagna 27 giugno 2016)*, available on *www.il sussidiario.net/News/ Politica/ 2016/6/27/Brexit-Referendum-Inghilterra-Unione-Europea-il-trucco-di-Cameron-e-bufera-in-Ue-conseguenze-Gran-Bretagna-27-giugno-2016*.

[37]See *BREXIT/ Referendum Unione Europea, Cameron: "Il risultato va accettato, restiamo uniti" (conseguenze Gran Bretagna 27 giugno 2016)",* cit.

[38]See CICERONE, *Oratio in Catilinam prima*, 1, 1.

[39]To have interpretative hint on this provision, formulated in *Brexit*'s occasion, see SANNA, *Brexit: cosa dice l'art. 50 TUE (Trattato sull'Unione Europea),* available on *www.news. biancolavoro.it/brexit-cosa-dice-lart-50-tue-trattato-sullunione-europea*.

from European Union (first paragraph), and its notification to the European Council. Therefore, pursuant to Art. 50, negotiations between the EU and the withdrawing country would be opened and they would conclude with «an agreement to define the modalities of withdrawal» (paragraph two). The Treaties «shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after notification» (third paragraph). Hence specific procedural rules regarding the participation of the withdrawing State to the Council sessions would be specified, together with the procedure in case of request for re-accession by the State who has previously exercised his withdrawal right.

It is clear that the European legislator has limited the exit time within two years in order to respect the wills of both the withdrawing State and the other EU States. Therefore, current British policies (set off by Cameron) do not convince international commentators as long as UK is actually risking to delay its withdrawal procedure, which will inevitably make it difficult to observe the mentioned maximum period of two years.

A central aspect of the mentioned European regulation is, on the one hand, the signing of an agreement with the withdrawing State, and on the other, the identification of the termination time for the applicability of the common treaties.[40] As regards the latter condition, the legislation does not provide specific constraints, and suggests that the parties are free to define the appropriate procedures that must be approved by the Council, as well as by the European Parliament. More specifically, the deadline for Treaties' applicability coincides with the date of entry into force of the withdrawal agreement, or anyway, in case of its absence, within two years.

Nonetheless, the literal meaning of the mentioned provision refers to

[40]See MANZINI, *Tre scenari per il day after*, available on *www.lavoce.info/archives/41573/brexit-tre-scenari-per-il-day-after*, where is presented the chance that the UK regulates the relationships with the EU non through a specific agreement, but through the acceptance of already existing treaties, like Efta (*European Free Trade Association*) or Eea (*European Economic Area*) or WTO (*World Trade Organization*).

"Treaties" that have been equally adopted by all EU member States; in this respect, all single negotiations between each European country and EU will be eventually no more effective in case of withdrawal. Hence, as a result of Brexit, UK's particular agreements with European Union will cease to exist as explained by European Commission with regard to the set of arrangements signed on last February (which, as already pointed out, has allowed "special concessions" to Britain and an "autonomous" position that we cannot recognize in other European countries)[41].

The reactions of European politicians to Brexit let presume that United Kingdom will not benefit from past privileges during the withdrawal procedure; in this respect, it is worth remembering that the European Parliament's majority has adopted a resolution to accelerate the UK exit and to cancel the presidency of the British semester planned for 2017.[42] It is also worth remembering the unequivocal statement made by the President of the European Council, Donald Tusk, who said "the EU is ready to go ahead ... even today".[43] In this respect, some comments made by Heads of Government of major EU countries seem to be relevant: I am particularly referring to Holland, who has underlined that "there is a timetable set by the Treaty ... but it can be accelerated. It depends on what UK is going to communicate about its future decisions".[44] I am referring also to our Italian Premier, Renzi, who has underlined the importance of European values and EU membership ("it is impossible to be part of a community, only by obtaining its benefits ...

[41]See the editorial by SALAMA, *European Commission Statement on Brexit - Full Text*, available on *www.fxstreet.com/news/european-commission-statement-on-brexit-full-text-201606241221*wheere it is underlined that «As agreed, the "New Settlement for the United Kingdom within the European Union", reached at the European Council on 18-19 February 2016, will now not take effect and ceases to exist. There will be no renegotiation». See also *European Council meeting (18 and 19 February 2016) – Conclusions*, Brussels, 19 February 2016.

[42]See MATTEUCCI, *Brexit, Parlamento Ue vota per 'attivazione immediata'. Merkel: "Referendum non può essere ribaltato"*, visionabile su *www.repubblica.it/ esteri/2016/06/28/ news/brexit_renzi_tutto_il_necessario_per_salvare_soldi_cittadini_e_merkel_contro_presidenza_di_turno_londra*.

[43]See MATTEUCCI, *Brexit, Parlamento Ue vota per 'attivazione immediata'. Merkel: "Referendum non può essere ribaltato", cit.*

[44]See the publishing entitled *Renzi, Holland e Merckel d'accordo: La Brexit non si farà adesso*, available on *www.liberoquotidiano.it/news/esteri/11923726/renzi–holland-e-merkel-d-accordo—la-brexit-non-si-fara-adesso*.

you cannot be a EU member just for its economic benefits, EU and Britain cannot be part of the single market without facing its relevant problems ... [Europe's one] ... such as immigration one").[45]

Certainly, a deeper analysis of Brexit tells us that Germany has played a specific role in EU behavior toward UK. More specifically, Germany has an underlying responsibility in managing all European policies, even those have been very unpopular among other Member States. It is clear that, in a geopolitical context marked by the hegemonic tendencies of that country,[46] UK has always interpreted European Union as a German project to extend its political and economic power, and hence it has been always worth of specific and gradual suspicious analysis. In fact, even if we can actually store Brexit as a past phenomenon, what now is rising a relevant concern are just Merkel's strategies and her "wait and see" behavior.[47] Doubts in this regard are being created by German desire to "reach out to the United Kingdom", so as to help UK find a loophole that delays the effects of the vote, which in turn means that German is actually setting off new negotiations and policies that could simplify its relationship with UK (without EU's influence).

7. The political assessment of British citizens, as it has been mentioned by the Italian Premier, "is an historical event", which should neither be minimized, neither exploited;[48] therefore, "those who tried today to minimize or to exploit what happened would be making a political mistake". Consequently, Brexit should give us pause for thought and should allow us to reflect about the relationship between democratic principles (and freedoms showed by UK referendum) and European integrity in order to solve the problematic issues discussed in the previous

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[45]See the publishing entitled *Il Parlamento Ue vota la mozione per una Brexit veloce*, available on *www.globalist.it/world/articolo/202686/il-parlamento-ue-vota-la-mozione-per-una-brexit-veloce .html*.

[46]See CAPRIGLIONE – SACCO GINEVRI, *Politics and Finance in the European Union. The Reasons for a Difficult Encounter*, p. 200 ss.

[47]See DEMPSEY, *Why Brexit will be Angela Merkel's greatest test,* available on *www.washingtonpost.com/opinions/ global-opinions/why-brexit-will-be-angela-merkels-greatest-tes.*

[48]See the publishing *Renzi, Brexit pesa sulla storia della UE,* available on *www.ansa.it/sito/notizie/politica/2016/ 06/24/brexit-renzi-sente-merkel-e-hollande.*

pages. The Union must prevent events like Brexit, because they could cause further damages, which could affect worse European financial stability.

As mentioned during several European political leaders' meetings, that have succeeded with unusual frequency in the days after the referendum, an internal dialectical process is needed among member States in order to evaluate any indicator of a possible political crisis that could threaten the European identity (in which many member States may no longer recognise themselves, hence jeopardizing the Union project).

As a matter of fact, British vote (mostly considered as dissenting vote against EU) reflects popular disappointment against EU, specifically due to the lack of economic growth (which instead characterised only few countries within Europe) that was largely expected by member States in medium term. Hence, the criticism expressed by the British population represents an attack to European policies and to the entire development of EU that has not been able to achieve adequate development programs and in which the integration (meant as free movement of persons) is considered as a threat, and a dangerous attack to the welfare state that citizens (bothered by a decade of economic austerity) do not want to lose.

Therefore, Member States are facing a reality that was not predictable so far. Providing an urgent and firm response to Brexit is the necessary precondition to prevent populism and xenophobic movements that could spread among States and take advantage of the climate of uncertainty that nowadays characterizes relations between countries in the "old Europe" ; in this respect, the words of Romano Prodi represent a real warning: "The European project has not yet reached the point of no return, ... (so) ... Europe could also fail".[49]

So Europe is facing a need for a deep change of policies that EU is pursuing, hence the perverse circuit (that could lead to an EU implosion) will stop. In that sense, the acceptance of the referendum decision – although it may seem anti-his-

[49]See the speech of March 23rd, 2007 in the Senato of the Italian Republic.

torical, due to its opposition to the Europeanisation process – would benefit the European framework and the purpose of revising the project to build a “common house” for Europeans.

In this logical order, the document “*The European Commission Working Programme 2016*” seems to be relevant as long as it illustrates initiatives and institutional measures UE should adopt during the present year.[50] The need for a new “Strategic Agenda”, as mentioned by the European Council during a meeting in late June, might entail an integration of the mentioned document, hence this would include specific tools and incentives to support youth work, plans for growth and competitiveness, and measures against legal immigration.

This is the real challenge Europe is actually facing: moreover, it implies the overcoming of current policies that could jeopardise the continuity of the Union! At the same time, any further development and future after-Brexit event seems unpredictable. The only thing that appears very certain and clear is the unavoidable acknowledgment that Europe needs urgent and not postponable changes in order to save EU integrity.

8. Based on the foregoing, it appears obvious that the Brexit vote has worked as a catalyst to unveil weaknesses that, as things are, affect the EU. The uncertainty that followed confirms the limits of the current structure, incapable of succeeding in promptly finding within itself the solutions required to overcome the moment of serious difficulties which the Union faces as a result of the referendum vote (a vote that, perhaps, was cast without an adequate assessment of its actual implications).

An erroneous political decision – taken in order to isolate (and defeat) the populistic factions of a Great Britain that have not managed to assess with clarity the consequences of such a decision – fostered by the traditional poor empathy of the UK population with Continental countries, has resulted in a dangerous boom-

[50]Available on *www.senato.it/japp/bgt/showdoc/17/DOSSIER/958346/index.html?part= dossier _dossier1-sezione_sezione2&parse=si&spart=si.*

erang destined to hit not only the United Kingdom, but also the entire European regional context. In this respect, no help has been offered by the concessions whereby, on several occasions, the Union has met the requests by the British governmental bodies; it is also thanks to these generous concessions that the UK has been allowed to enjoy a "privileged position" in comparison with the other Member States!

Nevertheless, this now belongs to an irreversible past! What remains is just the sour observation that the Brexit is the outcome of an electoral campaign which relied upon – as highlighted above – the nostalgic memories of a past that cannot be returned to, as well as, secondly and more importantly, the lack of awareness of a "European project" which, in turn, has bolstered the threats of a migration flow from other countries of the Union).

Hence the environment, that I would not hesitate to define "twisted" and artificial, which has come to fruition in the decision to exit the EU. Contributory factors of this environment have been the misleading information provided to the electorate[51] as well as the limited engagement by the political side deputed to support the *Remain.*[52]

The loss of a co-traveler is always an unpleasant event, in some cases even traumatic: this is true especially when, as it happened in the EU referendum in Britain, the matter is concerned with a country which, for centuries, has played a pivotal role in the history of Europe! It provides a certain degree of comfort the thought that, in this specific case, "everything and even more" has been offered in order to convince Britain to carry on along a common path, which is now all of a sudden interrupted as a result of a decision in which the "whole feeling" of a majority side of the British population is reflected. Therefore, it appears tacitly repri-

[51]See *supra* note no. 30.
[52]See the column *Brexit, la disfatta di Corbyn. Media: "Guerra civile nel Labour. Peggiore crisi del partito dal 1935"*,available on *www.ilfattoquotidiano.it/2016/06/27/brexit-la-disfatta-di-corbyn-media-guerra-civile-nel-labour-peg-gio-re-crisi-del-partito-dal-1935*. In this contribution, express reference is made to the «storm on Corbyn, leader of the main left-wing party in the United Kingdom, accused of not doing enough in the last months to convince the British to vote against the exit of the United Kingdom from the European Union».

manded the EU for not being able to effectively cope with the issues raised by the European process;[53] in view of this target, the full integration was clearly required, integration that, on the other hand, Britain has always firmly opposed. It suffices, for all, to recall the immigration matter as well as the implicit need for a common foreign policy!

In light of these considerations, it is understandable the *domino* effect sparked on by the Brexit on the separatist trends that, nowadays, undermine the *continuity* of the Union. Furthermore, Brexit is also responsible for the new scenarios of discomfort of other EU Member States, due to the likely demarcation line between the stances of Germany on the one hand, and on the other hand those of other "supporting actors" (France and Italy), the latter countries being determined to promptly exit the *marshlands* of the post-referendum uncertainty and, therefore, clearly unprepared to accept the delayed and cautious solutions put forward by the former. This is, with all likelihood, a danger not adequately taken into account in the assessment of the possible features of imbalance, which the event under discussion have prompted.

It is obvious that an *intelligent* handling of the phase subsequent to the Brexit – as I have sought to highlight in the previous pages – cannot refrain from dealing with a joint effort of all the Member States in confirming, with a sense of responsibility, the commitment undertaken with the adhesion to the Treaties; notwithstanding the fact that «no one, let alone the English, is allowed to damage all with arbitrary delays».[54] It follows from this the need for strengthening forms of cooperation in order to allow the EU to revamp a growth program, hinged upon the rejection of the austerity logic in favor of both a revitalizing cohesion and a solidarity respectful of human dignity. The search for new paths towards the integration, which on the one hand brings growth and on the other hand consolidates

[53]See the publishing *Brexit. Al Consiglio Ue ultima cena con David Cameron: gelo sul premier britannico, ma è impasse fino a settembre*, visionabile su *www.huffingtonpost.it/2016/06/28/brexit-consiglio-ue_n_10719956.html*.
[54]See NAPOLETANO, *L'intelligenza politica ed in senso dell'urgenza*, *IlSole24Ore*, June 28th, 2016.

the harmony within the EU, identifies in actual terms the most appropriate way to make sure that the damage caused by the *Brexit* does not reach so high a level as to shatter the «European dream» in which, ultimately, the vast majority of the people of the Union, including the young generation of the United Kingdom, continue to believe in.

ADMINISTRATIVE AND TRANSACTION COSTS ARISING FROM BREXIT. A REGULATORY CHALLENGE

Sandro Amorosino* - Valerio Lemma**

'We have stood here alone in what is called isolation – our splendid isolation, as one of our colonial friends was good enough to call it.'
Lord Goschen, Lewes, 26 February 1896

ABSTRACT: *Brexit opens the way to the negotiation for United Kingdom's exiting the European Union, and this paper analyses the implications of these negotiations on the regulation of the Internal Market, by considering the possible transformation of the applicable regulations and mechanisms of supervision.*

The research takes into account the administrative and transaction costs related to the procedure provided by Article 50 of the Treaty on the European Union, because the EU regulatory framework did not rely on a mere exit procedure, but requires a real negotiation. In this context, the timing is a useful data for the actuarial calculations, but the computation of the relevant costs results more complex. Our findings show also an asymmetry (between the interests of UK and the ones of EU) that both weights on the assessment of the incentives pushing in investing in this negotiation, and highlights the risk that one of the parties shall intentionally delay the discussion about any single clause.

The analysis focuses on the possibility that, as a result of the exiting, EU financial markets will be exposed to the competitive action of the British regulator, which can implement rules that are less expensive than those recently provided by EU directives and regulations. Consequently, the efficiency of the Brexit requires

*Full Professor of Economic and Financial Markets Law at the Università La Sapienza of Rome. He is Honorary President of the Italian Association of Teachers of Economic Law.
**Associate Professor of Law and economics at Università degli Studi Guglielmo Marconi of Rome.
Although this paper is the result of a joint reflection of the authors, which wrote together the introduction and the conclusions, Sandro Amorosino wrote the paragraphs 2 - 3 and Valerio Lemma wrote the paragraphs 4-6.

the safe and sound use of the negotiating opportunities, because a competitive approach (made by the United Kingdom or the European Union) shall not comply with the need for the stability of finance felt by the industry.

SUMMARY: 1. Introduction - 2. Brexit and possible transformation of the capital market. - 3. Current scenario. - 4. The negotiation of Brexit. - 5. The influence of negotiation on the costs of market connection and its supervision. - 6. The need for the uniformity of market mechanism and the harmonization of the regulation. - 7. Conclusions.

1. 'Brexit means brexit'.[1] And also means negotiation for exiting the European Union, and then administrative and transactional costs for both the United Kingdom (of Great Britain and Northern Ireland) and the EU. According to the recent debates at the House of Commons concerning the question on legal process for exiting the EU, we shall move from a clear premise: the referendum clarifies people's will to withdraw the United Kingdom's membership of the European Union, but it does not helps in understanding its will about the path that the British Government should follow to leave the EU. Moreover, this vote does not provide any directions on the timing of the 'Brexit'.

Whether the decision to begin the aforesaid process requires an executive order from the Prime Minister or an act of the Parliament, we expect that the British Government shall follow EU rules in exiting this Union,[2] and we also envisage that the politicians should take into account also the rights of the minority willing to remain.[3]

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[1]See *Theresa May says 'Brexit means Brexit' and there will be no attempt to remain inside EU*, in *The Independent*, 11 July 2016. We shall also consider the statement delivered by Prime Minister David Cameron after British voters in a referendum elected to leave the European Union: "The British people have voted to leave the European Union, and their will must be respected", see www.nytimes.com, 23rd June 2016.

[2]"A negotiation with the European Union will need to begin under a new prime minister, and I think it is right that this new prime minister takes the decision about when to trigger Article 50 and start the formal and legal process of leaving the E.U.", see the statement delivered by Prime Minister David Cameron after British voters in a referendum elected to leave the European Union, cit.

[3]"We must now prepare for a negotiation with the European Union. This will need to involve the full engagement of the Scottish, Welsh and Northern Ireland governments to ensure that the interests of all parts of our United Kingdom are protected and advanced", see the statement

Therefore, British politicians are entitled to activate any relationship to set out the arrangements for the withdrawal, given that they shall comply with voters' will in regulating the exiting from the Union and the framework for UK's future relationship with the EU and the Members States.

Because of a various range of regulatory options - which provide, on one side, the conservation of a link with the 'internal market' (by recognizing one or more fundamental freedom of the EU), and on the other the qualification as a 'third country' - we can identify the (social and economic) costs to draft new arrangements (able to close and then rearrange the relationship that, so far, have been in the scope of the European integration process). [4]

Hence, the need for a cost analysis to understand the administrative expenses to be considered in the public finance of United Kingdom, European Union and Member States) throughout the stages following the British referendum. According to the first evidences arising from the relevant market trends, this analysis shall consider also the dissolution of the financial mechanisms for the circulation of wealth that, till now, enact the 'free movement of capital' provided by the Treaty of the EU. [5]

The underlying theme concerns the economic convenience of the Brexit choice and, in particular, of its consequences: the *desertion* of the harmonization (or rather the uniformity) of the rules for capital market functioning (achieved by the European Union),[6] whereby concrete gains in the efficiency (of the British financial conduits) could justify a rational and positive assessment of this *affaire*.

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delivered by Prime Minister David Cameron after British voters in a referendum elected to leave the European Union, cit.

[4]See Oral statement to Parliament from the Prime Minister's Office, 10 Downing Street, The Rt Hon David Cameron MP and Cabinet Office, *PM Commons statement on the result of the EU referendum: 27 June 2016*, 27 June 2016

[5]See VV.AA., *A new business engagement inter-ministerial group bringing together ministers from across government has been established*, Department for Business, Innovation & Skills, UK Trade & Investment, The Rt Hon Sajid Javid MP, Department for Culture, Media & Sport, and others, 30 June 2016

[6]See CAPRIGLIONE, *UK Referendum and Brexit Hypothesis (The Way Out Perspective and the Convenience to 'Remain United')*, in *Open Review of Management, Banking and Finance*, March 2016

2. Brexit raised many doubts about its effects on the financial centres arranged by bylaws compliant to EU law.[7]

Principle of the creation of EU internal market was the *liberal aim* of both the Directive no. 73/183/EEC and no. 77/780/EEC for credit and financial activities.[8] Therefore, the will of resolving the legal connection to the internal market is going to interact with the architecture of the legal order and, then, on the way of finance interplays with public interests. After all, the internal market for capital and financial services is not only subject to EU rules, but also is under the broad supervision of EU authorities (*i.e.* the ESFS), the influence of action plans (*i.e.* the FSAP of 1999) and the policy decision of the European Commission (and in particular the DG FISMA),[9] in order to achieve the welfare goals provided by the EU Treaties. Nevertheless, any industry of the capital market has its own features; hence, the analysis of the incidence of the Brexit shall apply a different approach for banking, financial services, insurance, and other relevant sectors.

In this context, we shall consider both the multiplicity of sources of law and regulation (which goes from the EU organisms to the national authorities) and the lability of them both (and in particular of those without any coercive force, ascribable to soft law).[10] Consequently, there is a set of problems - to be solved by dissolving the link of EU/UK - related to the increasing (in level and species) type of the subjects that provide the rules able to order the capital market, whence the

[7]See CAPRIGLIONE, *Brexit: un divorzio antistorico che può cambiare l'UE*, in *apertacontrada.it*, 5 July 2016

[8]See SICLARI, *Context, Specific Features and Potential Evolution of the Italian Banking and Financial Law*, in VV.AA., *Italian Banking and Financial Law: Supervisory Authorities and Supervision*, London, 2015, p. 3 ff. and CAPRIGLIONE, *Fonti Normative*, in VV.AA., *Manuale di Diritto Bancario e finanziario*, Padova, 2015, p. 12

[9]The Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) is one of the Directorates-General and specialized services that make up the European Commission. Valdis Dombrovskis, Vice-President responsible for the Euro and Social Dialogue, has taken over the portfolio for Financial Stability, Financial Services and Capital Markets Union after the resignation of Commissioner Jonathan Hill

[10]See AMOROSINO, *Principi "costituzionali", poteri pubblici e fonti normative in tema di mercati finanziari*, in VV.AA., *Manuale di diritto del mercato finanziario*, edited by Id., Bologna, 2014, p. 14 ff., and PELLEGRINI, *L'architettura di vertice dell'ordinamento finanziario europeo: funzioni e limiti della supervisione*, in *Rivista Trimestrale Diritto dell'Economia*, 2012, n. 2, p. 52 ff.

matters about the competition among rules.[11]

Obviously, the arrangements following the Brexit and the negotiation provided by article 50 of the Treaty on the European Union will mainly concern the dissolution of the ‘level playing field’ provided by the EU regulation while financial engineering was weaving its web across the relevant markets placed in the Member States.[12] On the other hand, we shall consider that these are the parameters for any valuation about the efficiency of the British isolationism.

Undoubtedly, this phenomenon does not interact with the all the sources of law. Rather, it identifies a (meaningful) *discontinuity* in the transposition of the substitute law coming from the framework of global regulation, because the following pieces of hard law made by the RU legislative bodies will not be applicable to British markets and operators.[13] In other words, after the exiting from the EU, UK’s authorities will be the only responsible bodies for the development of the inputs provided by the global regulators in their national markets. Hence, there is a divergence between the role of the firsts (*i.e.* the UK’s authorities) and the one of the homologous authorities of the Members States (that will carry on the *more limited* power to enact national discretions and options).

Fluidity (of capitalistic scenarios) and technicalities (of financial operations) influence the choices of the regulators and, therefore, suggest a possible convergence of UK’s and EU’s authorities due to a mutual inference in drafting the rules that will oversee the exchange of capitals and the (banking, financial and insurance) services related to it.

On this point, we cannot underestimate the role of the *integration* achieved by the most important professional operators and, in particular, the one

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[11]It is useful to bear in mind the considerations of GIANNINI, *Osservazioni sulla disciplina della funzione creditizia*, in *Scritti giuridici in onore di Santi Romano*, Padova, 1940, II, p. 714 ff., latelty recalled in *Il nuovo testo unico delle leggi bancarie e l’ordinamento sezionale del credito*, in VV.AA., *Le banche: regole e mercato*, edited by Amorosino, Milano, 1995, p. 7 ff.

[12]See SICLARI, Gold plating *e nuovi principi di vigilanza regolamentare sui mercati finanziari*, in *Amministrazione in cammino*, 2007

[13]See, on the relationship between juridical globalization and public powers CASSESE, *Il diritto globale*, Torino, 2009, p. 31 ff.; see also GERSEN - POSNER, *Soft Law*, *U. of Chicago, Public Law and Legal Theory Working Paper*, No. 213/2008

of the companies managing London and Milan stock exchanges, and the ancillary 'merger of equals of Deutsche Börse AG (Deutsche Börse) and London Stock Exchange Group plc (LSEG)'.[14] These operations objectify (and so make less abstract) the operational criteria, organizational structures and procedures which are necessarily in the scope of the one (of the EU Member States) and the other (of the United Kingdom) legal order.

Thus, under the scenario set by the Brexit, we cannot find the possibility of *mere* influences (made by sources placed out of the jurisdiction), but the need for the cross-border operators to comply with two judicial systems that depend on two different *unities* (*i.e.* EU and UK). Consequently, this work shall consider the occurred mutation in the political view of the relations between public powers and economical activities (*i.e.* between State and market, to use a classic formula).[15]

3. Over the past few years, the forms and the contents of the regulation concerning financial activities have been rapidly changed under the pressure of the crisis.[16] Private and public finances have frequently interplayed, being able to contaminate one another (that is from subprime mortgages to sovereign debt), and they both still interplay, as the Brexit is influencing the market trends, currency exchange rates and credit institutions). This scenario underlies a context ordered under neo/ordo-liberalistic models, providing that specific safeguards (made by EU authorities) are tempering the market freedom, in order both to protect widespread interests (related to a proper functioning of the trading venues) and to reduce the economic imbalances that prevent the maximization of the so-

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[14]We refer to the official document "*Merger of equals: Deutsche Börse - LSE*", available at deutsche-boerse.com

[15]See AMOROSINO, *Markets transformations, new regulation models and economy law's mission* in *Rivista Trimestrale di Diritto dell'Economia*, 2016, p. 182

[16]See CAPRIGLIONE - SACCO GINEVRI, *Politics and Finance in the European Union. The Reasons for a Difficult Encounter*, Padova, 2015, p. 81 ff.

cial welfare.[17]

In this context, the option for Brexit represents the choice for turning back to self-determination, because as a result of the withdrawal procedure the *location* of any decision concerning the public intervention on private markets will be domestic. Therefore, the subjects of Her Majesty the Queen, by means of this vote, had shown both a clear preference for the revocation of the powers shared within the Union, and a refusal for the high-ranking position of the EU legal order (over the UK's one[18]), given that the European Communities Act of 1972 implicitly recognised the primacy of EU law over UK law [19]

On this point, we shall also consider the Brexit as a loss of contribution provided by United Kingdom to the European common organization and, in particular, the incentive to take into account the perspective arising from a 'common law approach'.[20] However, we shall also contemplate that UK joined late the European Community and, often, remained on the borders of this organization (by using opt-out clauses[21]).

Meaningful insights on the directions of British institutions can be gathering from the resignation by Commissioner Lord Hill, responsible for Financial Stability, Financial Services and the Capital Markets Union, dated 25 June 2016, and from the absence of the UK permanent representative, as country ambassador, to the

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[17]See PIKETTY, *Capital in the Twenty-First Century*, Harvard, 2013, *passim*; we also refer to the previous analysis, Id., *Imperfect Capital Markets and Persistence of Initial Wealth Inequalities*, in *LSE STICERD Research Paper No. TE255*, 1992, .

[18]See CARAVITA, *Brexit: Keep calm and apply the European Constitution*, in *Federalismi.it*, 29 June 2016, p. 3 ff.

[19]See LOTUS, *L'ordre juridique communoutaire*, IV ed., Bruxelles, 1988, p. 14 ff.; AMOROSINO - PREDIERI, *Commento sub art. 6 d. lgs. 385 del 1993*, in VV.AA., *Commentario al testo unico delle leggi in materia bancaria e creditizi*, edited by Capriglione, 2012, p. 75 ff.

[20]See SAVASTANO, *Sulle conseguenze di un eventuale Brexit*, in *Federalismi*.it, 9 December 2015, p. 6 where it is noted that UK is the second EU economy, and losing it would mean giving up on a Member State whose contribution to the European budget is certainly significant.

[21]See CARAVITA, *Brexit: Keep calm and apply the European Constitution*, cit.
In this regard, it is appropriate to recall the words of Lord Goschen, Lewes 'We have stood here alone in what is called isolation – our splendid isolation, as one of our colonial friends was good enough to call it', explanatory of the British end-800 tendency not to take part in the continental events, See also CHARMLEY, *Splendid Isolation? Britain and the Balance of Power 1874–1914*, Sceptre, 1999.

COREPER of the 26 June 2016, prepared to set up the forthcoming European Council.[22]

Curiosity arises, then, about any next behaviour of the British member of the European Parliament; and this curiosity concerns both the votes on the 'withdrawal agreement' (which, at that moment, will be the result of negotiation made by the United Kingdom and then already wanted by their own country), and above all the votes on the acts that will enter into force after the Brexit and then will apply only to remaining Member States.[23]

We shall not assess the political implication of exiting the European Union (in its meaning of segregated institution, independent from its Members States, ruled by its own bylaws and managed under its own procedures, connected by reciprocal penetration of legal systems and bodies[24]). What an accurate *economic analysis of law* shall assess is the *total utility* of an active, autonomous and oriented use of the regulatory powers that, after the Brexit, will go back to sovereignty sphere of the English Crown. Obviously, this analysis will resolve the doubt that the Brexit will not eliminate the results gained by the work of juridical rationalization made by EU bodies since the 'Lisbon Strategy' in 2000s, neither that it will increase the costs for the functioning of the regulated markets, where finance has a leading role, the financial instruments are the main tools able to support the manufacturing firms, and the banking system has the duty to stabilize the economy.[25]

At the same time, the analysis on the (European and British) public intervention will clarify the uncertainty due to the result of this referendum. This uncertainty does not affect the fundamental freedoms of European citizens, but shall weight on the planning of firms (and then on the decisions concerning labour and

[22]See CURTI GIALDINO, *Oltre la Brexit: brevi note sulle implicazioni giuridiche e politiche per il futuro prossimo dell'Unione europea*, in *Federalismi.it*, 29 June 2016, p. 24

[23]See CRAIG, *Brexit: A Drama in Six Acts*, in *European Law Review*, August 2016 and *Oxford Legal Studies Research Paper*, No. 45/2016

[24]We can recall a set of judgement made by the ECC Court of Justice: 20 September 1988, c. 31/87; 19 June 1990, c. 213/89; 24 March 1987, c. 286/85

[25]See AMOROSINO - PREDIERI, *Commento sub art. 6 d. lgs. 385 del 1993*, cit., p. 75 ff.

movement in the European industries). Hence, the importance of the following statement made by the Chancellor of the Exchequer: 'this will have an impact on the economy and the public finances – and there will need to be action to address that'.[26]

To Summarize. EU and UK are challenging the need for a new synthesis to recast the British legal order concerning the domestic financial market and its links to the foreign ones. Both these actions, in fact, try to be achieved by an effective use of the negotiation procedure provided by article 50 of the Treaty on the European Union, able to safeguard the positive outcomes in the last decade of financial regulation.

4. In the light of the above, we can understand that the actual text of the referendum question (that is the choice between *leave* or *remain*)[27] did not ask to the British citizens anything about the *timing* for exiting the European Union, neither its *contents* (given that the remain option will enact a *special status* for the United Kingdom[28]).

Consequently, we shall consider that the choice to 'withdraw from the Union' will go under the limit of the 'own constitutional requirements' provided the Member State which asks for exiting (according to Article 50 of the Treaty on the European Union). [29] However, on this point, the European Treaty provides - to-

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[26]*Statement* by the Chancellor of the Exchequer, George Osborne following the outcome of the EU referendum; HM Treasury and The Rt Hon George Osborne, 27 June 2016

[27]See ELEFTHERIADIS - ARMOUR - ENRIQUES - MOONEY - WILLIAMS - YOUNG, *Legal Aspects of Withdrawal from the EU: A Briefing Note*, in *Oxford Legal Studies Research Paper*, No. 47/2016

[28]See CAPRIGLIONE, *UK Referendum and Brexit Hypothesis (The Way Out Perspective and the Convenience to 'Remain United')*, in *Open Review of Management, Banking and Finance*, March 2016

[29]See DOUGLAS - SCOTT , *A UK Exit from the EU: The End of the United Kingdom or a New Constitutional Dawn?*, in *Cambridge Journal of International and Comparative Law*, 2015, and *Oxford Legal Studies Research Paper*, No. 25/2015.

In this connection, it comes to mind the considerations on the membership during the EEC regime, stated by WEILER, *Alternative to withdrawal from an International Organization: the Case of the European Economic Community*, in *Israel Law Review*, 20, 1985, p. 285, and those of HILL, *The European Economic Community: The Right of Member States Withdrawal*, in *Georgia Journal of International and Comparative Law*, 12, 1982, p. 337.

gether with a notification to the 'European Council' - the duty to 'negotiate and conclude an agreement with that State', according 'the guidelines provided by the European Council' and 'taking account of the framework for its future relationship with the Union'.[30] Therefore, in the legal perspective, we shall identify the object of the relations that these negotiations shall put in place between the UK and EU: (i) the recovering of UK's full sovereignty and (ii) the drafting of new bilateral agreements with a Country becoming third (to the EU).[31]

Two years since the notification is the specific limit to close the withdrawal agreement, by enacting the procedure provided by article 218(3) of the Treaty on the Functioning of the European Union (concerning the 'agreements between the Union and third countries or international organisations'). After this period 'the Treaties shall cease to apply to the State in question'.[32] And on this point, we cannot rely on the recent experience of the EU-US trade agreement named TIPP.[33]

From a law and economics perspective, this means not only an 'exit' procedure, but a real negotiation (or, in other words, renegotiation). We are not dealing with an *unilateral* act of termination, but with a bilateral negotiation to set up the regulation of the legal regime of the future reciprocal relationships. Undoubtedly, the *falling* of the 'public enforcement' of EU treaties in the British homeland will call for specific actions, within specific deadlines, to enact the provision of the withdrawal agreement (according to mentioned Article 50). Hence, the need for the efficiency of this agreement, taking into account the possibility to apply the

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[30]See PUGLIA, *Art. 50 Treaty on the European Union*, in VV.AA., *Trattati dell'Unione europea*, edited by Tizzano, Milano, 2014, p. 339 ff. and, most recently, SAVASTANO, *Prime osservazioni sul diritto di recedere dall'Unione europea*, in *Federalismi*, 2015, 25 November 2015.

[31]See LANG, *The Consequences of Brexit: Some Complications From International Law*, in *LSE Law: Policy Briefing Paper*, No. 3/2014.

We note in this regard the judgements Solange I (BVerfGE 37, 271 del 29 may1974) and Solange II (BVerfGe 73, 339, 22 October 1986), Maastricht (BVerfGE 89, 155, 12 october 1993), Bananenmarkt (BVerfGE 102, 147, 7 June 2000) and Lissabon (BVerfGE 123, 267, 30 June 2009), related to the distinction between share and pool sovereignty made by FABBRINI, *Which European Union? Europe after the Euro crisis*, Cambridge, 2015, p. 68 ff.

[32]The meaning of this option is clarified by the unlimited duration of the Union, ex art. 53, Treaty on the European Union and art. 356, Treaty on the Functioning of the European Union.

[33]See MUNSHI - SYMON - HARRIS, *German minister says TTIP has failed…*, in *FT.com*, 28 August 2016.

mutually beneficial (or, in economical words, *Pareto efficient*) negotiating models, and the risk to draft an *incompletely specified text*.[34]

Currently, the procedure for the 'voluntary withdraw' provided by the Treaty of Lisbon[35] is the first element of certainty following the result of the Brexit referendum.[36] This is a procedure that set an external limit to the associative (*rectius*: unional) phenomenon in consideration.

And, in this context, the timing (*i.e.* two years) is an useful data to be considered in the actuarial calculation made to forecast the economical-financial burden of Brexit. Despite this, more complex is the computation of the costs arising from this discontinuity in the construction of the internal market, given that (obviously) the withdrawal will affect both the interconnections of the trading venues (for capital and financial instruments) and the public controls on activities regulated by EU rules (and several remarks about that are worth making).[37]

Furthermore, we shall take into account the 'costliness of negotiation' and, nonetheless, the expectation related to the presence or absence of a withdrawal agreement together with the 'desirability of enforcement' of the latter. So, we shall refer to the conclusion reached by the relevant doctrine that, on this matter, stated that 'for somewhat subtle reasons … it is not always true that the enforcement of renegotiated contracts will help the parties prospectively'.[38]

Concluding remarks on this point shall consider that Brexit arises questions

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[34]See SHAVELL, *Foundations of economic analysis of law*, Harvard, 2004, pp. 292 - 293 where it is clarified that 'an incomplete contract that does not provide a complete set of instructions explicitly or by implication is said to have *gaps*'.

[35]Such withdrawal procedure had been introduced in the 'Treaty establishing a Constitution for Europe' (signed in Rome in 2004, but never ratified).

[36]Notes in this regard the interpretation of the *Statement* by the Chancellor of the Exchequer, George Osborne, following the outcome of the EU referendum; HM Treasury and The Rt Hon George Osborne, 27 June 2016, where it is stated that 'Only the UK can trigger Article 50, and in my judgement we should only do that when there is a clear view about what new arrangement we are seeking with our European neighbors'.

[37]See COOTER - ULEN, *Law and economics*, Boston, 2011, p. 91 where there is an analysis of the key elements of transaction costs, and p 95 ff. where the Authors focus on the level of them and the appropriate legal rule.

[38]See SHAVELL, *Foundations of economic analysis of law*, Harvard, 2004, p. 319, nt. 35, where the A. refers to the 1990s works of Fudenberg and Tirole.

on both the costs due to the disapplication of EU legal order to British (financial) markets, and the total utility (or rather the *social desirability*) of the withdrawal agreement.[39] Other doubts concern the asymmetric information (in the negotiation procedures) and the externalities related to market trends.[40] Indeed, to these (costs and utility) will refer the rational choice of closing a new deal between UK an EU.

5. Strategy and goals of the (individuals representing the) negotiating parties are the *economic foundations* influencing the tracking of a path able to minimize administrative costs and to gain efficiency.[41] The same will incentive or disincentive specific conducts and then will have a bearing on the possibility that the withdrawal agreement will be more useful than its absence (*i.e.* the sole termination of EU primary and secondary sources, that is the option applicable in the event of an unsuccessful overcoming of the expiring date).

We shall take into account the choice to entrust the most important EU bodies with the negotiating powers (and related responsibilities). Indeed, EU laws provide that the withdrawal agreement 'shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament'. [42] Obviously, the individual (of the European Council or of the Council) representing the withdrawing Member State shall not participate in the discussions of the decisions concerning the above negotiation (*ex* Article 50,

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[39]See POSNER, *The New Institutional Economics Meets Law and Economics*, in *Journal of Institutional and Theoretical Economics*, 1993, vol. 149, n. 1, p. 73 ff.

[40]Therefore, in addressing these issues with a law and economics approach, the focus must be on the welfare assessment models that better suited to the relevant regulatory environment, in order to identify what are the indicators that will guide the negotiators in the performance of their institutional responsibilities; see STIGLITZ - SEN - FITOUSSI, *Mismeasuring Our Lives: Why GDP Doesn't Add Up*, New York, 2010

[41]It goes without saying that the above consideration is subject to the assumption that the negotiators of Brexit behave in a rational way, that is to say 'they are forward looking and behave so as to maximize their expected utility'; See SHAVELL, *Foundations of economic analysis of law*, Harvard, 2004, p. 1; see also STIGLITZ, *The price of inequality*, New York, 2012, p. xi, on the specific problems raised by the failure of markets in the recent crisis, and p. 52 on the implications of inequalities in the financial markets.

[42]See Article 238(3)(b) of the Treaty on the Functioning of the European Union.

paragraph 4, of the Treaty on the European Union).[43]

This is a more effective legal set up than the one generally provided by the Vienna Convention on the Law of Treaties (of 1969), based on the 'consent of all the parties after consultation with the other contracting States' (*ex* Article 54). Furthermore, this is true considering that whether the treaty does not contain any provision regarding termination, denunciation or withdrawal, the party shall agree that ' it is established that the parties intended to admit the possibility of denunciation or withdrawal; or a right of denunciation or withdrawal may be implied by the nature of the treaty' (*ex* Article 56).

Consequently, the negotiation will settle, on the one hand, the interest of the 'exiting State' and, on the other, the interests of the remaining 'Member States' that shall be jointly taken into account, but limited to the 'objectives they have in common' (*ex* Article 1, Tr. E.U.).[44] Indeed, the Treaty on the European Union design the withdrawal procedure in clear terms, and it puts the safekeeping of the interests they have in common before the ones of any single Member State. Despite this, Member States are entitled with a role limited to express their voice in a qualified majority voting, and they can set up bilateral agreements following the one signed by EU and UK. [45] Henceforth, the problem in computing (and estimating) the effects of the withdrawal on the relevant set of citizens, whereby there is the need for pondering both the total value costs of the agreement and their expected distribution among the Member States (in order to understand if these costs will not spread efficiently across the European area, but will concentrate only within certain countries or regions).[46]

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[43]See BARRETT, *The Era of Article 50: How the UK Will Leave the EU If it Opts for Brexit in its 23 June, 2016 Vote*, in *UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper*, No. 02/2016

[44]See HESTERMEYER, *How Brexit Will Happen: A Brief Primer on EU Law and Constitutional Law Questions Raised by Brexit*, in *Journal of International Arbitration*, 2016

[45]See SIEBERSON, *Inching Toward EU Supranationalism? Qualified Majority Voting and Unanimity Under the Treaty of Lisbon*, in *Virginia Journal of International Law*, Vol. 50, No. 4, 2010

[46]See KOCHENOV, *EU Citizenship and Withdrawals from the Union: How Inevitable Is the Radical Downgrading of Rights?*, in *LEQS Paper* , No. 111/2016

Undoubtedly, there is an asymmetry between the 'contracting parties' (*i.e.* UK and EU) that can jeopardize the negotiation and then the possibility of an equilibrate and prompt settlement.[47] This asymmetry, in fact, weights on the assessment of the incentives pushing in investing in the negotiation relationship and implies the risk that one of the parties will intentionally delay the discussion about any single clause. Hence, the significance of the reliance (placed by the Member States while drafting the Treaty of Lisbon) in the fairness of the 'leaving State', which shall avoid any dilatory behaviour.

From a regulatory perspective, we shall consider that European sources of law (that is the ones provided by EU directives) are supported by British act of implementation that can justify the over-living of the rules provided by them. On the contrary, a support for the EU rules directly effective (that is the one provided by EU regulations) is more difficult to find (even considering that, often, the EU regulations require the Member State to adopt national secondary or complementary piece of regulation).[48]

All the above design a legal system which should, in principle, allow the maintaining of the *status quo res erant ante* Brexit and so an over-living of the EU-originated rules currently in force. Thus, our analysis can validate this option according to the principle that 'one legal rule will be said to be superior to a second if the first rule results in higher level of the stated measure of social welfare'.[49] So, the *social desirability* (of the Brexit) will arise from the utility of the relevant content of the withdrawal agreement for both the United Kingdom and the European Union. This result shall confirm the economical convenience of the dissolution of the aforesaid partnership.

According to the above, we shall also consider that the first stages of the last financial crisis (and so before the proposal for the Brexit referendum), UK

[47]See STIGLITZ, *The price of inequality*, New York, 2012, p. xi
[48]See SHAW, *Where Does the UK Belong?*, in *Edinburgh School of Law Research Paper* No. 2016/04
[49]See SHAVELL, *Foundations of economic analysis of law*, cit., p. 2

government put in place actions aimed to stabilize the economy, reduce the budget deficit, and help more people get into work than ever before. As the new UK's Prime Minister Theresa May said, British citizens are living through an important moment in their country's history: 'Following the referendum we face a time of great national change … As we leave the European Union, we will forge a bold, new positive role for ourselves in the world'.[50]

In this perspective, the withdrawal is an option that allows London politicians a specific interpretation of people's will to exit the EU. Indeed, to the winning of *leave* vote is following the will of the British Government to link the domestic economy with the EU internal market, in order to obtain specific outcomes able to compensate the costs of both the negotiation and the loss of the benefit due to the EU membership (and the related acquis *communautaire*).[51]

Explanatory of these directions is the establishment of the 'Department for Exiting the European Union'. It represents the *confluence* of the expertise, skills and duties required 'to support the UK's negotiations to leave the European Union and to establish the future relationship between the EU and the UK' in one only body responsible for 'working very closely with the UK's devolved administrations, Parliament, and a wide range of other interested parties on what the approach to those negotiations should be'.[52] Therefore, this confluence represents also a parameter to account the administrative costs of the negotiation for the withdrawal,

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[50]See the *Full transcript* of Theresa May's first speech as Britain's prime minister, in www.washingtonpost.com, 13 July 2016, where the Prime Minister concludes: 'that will be the mission of the government I lead, and together, we will build a better Britain'.

[51]And, in particular, the access to 'an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime', as well as to an internal market that 'shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance'.
Come to mind, in this regard, the considerations of CRAIG MARKAKIS, *The Euro Area, its Regulation and Impact on Non-Euro Member States*, in *Oxford Legal Studies Research Paper*, No. 11/2016.

[52]See Department for Exiting the European Union, *About us*, August 2016.

useful to apply specific multiples in order to cover the expenses that weights on the balance sheets of the European Union and of the other Member States involved in this negotiation. This Department, in fact, helps the Prime Minister by 'supporting bilateral discussions on EU exit with other European countries',[53] and this also proves the thesis that Brexit's *affaire* will direct weight on any Member State.[54]

On this point, the direct participation of national authorities - being against the exclusivity of the EU bodies' role - shall foster an agreement able to maximize the sum of the individual utilities of the sole Member States that has the votes required to approve a deal of this kind (in the relevant EU bodies' assemblies and committees) and not the total utility of the European Union (considered as a whole).[55] This shall imply a specific set up (of national reciprocal interests) that will not be able to safeguard the social welfare of all the European citizens. After all, it is hard to find a different interpretation taking into account that the mentioned Department is also responsible for 'leading and co-ordinating cross-government work to seize the opportunities and ensure a smooth process of exit on the best possible terms'.[56]

6. The results of the Brexit arises an associative (or rather dissociative) matter concerning the juridical order of the EU internal market. Obviously, the legal set up of the relevant international relations requires that Member States shall refer to this matter in compliance with the European Treaties and then aiming to reach a mutual consensual solutions.

In this perspective, therefore, the costs of the negotiation are directly proportional to the number of topic to negotiate, that is the number of question

[53]See Department for Exiting the European Union, *About us*, August 2016.
[54]See GRICE, *Brexit: Theresa May to bypass European Commission and appeal directly to EU leaders in bid to secure better deal*, in *Independent*, 28 July 2016.
[55]These considerations go further the general implications assessed by GORYUNOV - KIYUTSEVSKAYA - TRUNIN, *Brexit Results: Macroeconomic Risks*, in *Russian Economic Developments*, Moscow, 2016, No 7, p. 51 ff.
[56]See Department for Exiting the European Union, *About us*, August 2016.

placed under the scope of the EU authorities. In brief, we can say that this cost depends upon the results reached in the development of the internal market and in the harmonization of the applicable national regulations.[57] It goes without saying that the *complexity* of this matter is due to the number and the interdependence of the actions required for dissolving the current interconnections between the British and the internal markets, and the high grade of correlation of the latters.[58] Indeed, we shall also consider that the procedure provided by Article 50 of the Treaty on the European Union aims to avoid that the British Government implements an unilateral action plan (that is close to a mere termination or rather to a 'breach of contract').[59]

However, there is the need for monitoring the directions (of British Government and Parliament) related to the *enforcement* of the acts adopted by EU regulators that are going to enter into force on the days following the referendum. Hence, we shall focus on this regulatory phenomenon in order to identify the possible costs related to the forthcoming national regulation of the British markets. Undoubtedly, the European market integration process sustain the idea of competition, whereby 'there can be no reward without risk', given the 'combative nature of the free market'.[60] And, in this context, we shall focus on the possibility that the withdrawal procedure shall launch a sort of competition among the policy markers involved in negotiation, at a first stage, and among regulators, in the second

[57]See MANCINI, *Dalla vigilanza nazionale armonizzata alla* Banking Union, in *Quaderni di ricerca giuridica della consulenza legale*, Roma, 2013, n. 73.
[58]Significant on this point is the *Statement* made by Business Secretary Sajid Javid following a roundtable with Britain's business leaders, Department for Business, Innovation & Skills and The Rt Hon Sajid Javid MP, 28 June 2016: 'Following last week's historic decision by the British people, I've just chaired a meeting of the chairs of UK's largest business organizations, and CEOs and senior representatives from many of our biggest employers. … And this government is still 100% committed to making the UK the best place in Europe to start and grow a business. None of this has changed on Friday morning. None of this will change overnight. This is not the time for hasty decisions that will be regretted later. Rather, it is the time for government to work with businesses large and small up and down the country so they don't just deal with the challenges that the result brings, but are also able to embrace the opportunities that it creates. The biggest issue raised was the need to secure continued access to the single market'.
[59]See MICHAELS, *Does Brexit Spell the Death of Transnational Law?*, in *German Law Journal* (Brexit Suppl.), Vol. 17, p. 51 ff.
[60]See BERNSTEIN, *Capital ideas*, Honoken (N.J. - U.S.A.), 2005, p. 2

stage.[61]

Brexit negotiators shall bear in mind that the paradigm of the authorization (and then of the cross-border effectiveness of the latter) is a key element in regulating market functioning, and it is able to align the (public and private) incentives to the development of a specific head-quarter for each financial firm aimed to do business in the EU internal market (and so in an economic environment that is wider than the territory of the authorizing Member State). On the contrary, whether *Brexit negotiators* agree to disapply any common rule and, in particular, the ones related to 'Home Country Control Principle', we shall account also the cost, for British companies, of a set of authorizations (that can be considered as a whole only because of their ownership).[62]

In the internal market regulation, since Council Directive 93/22/EEC, the EU bodies sought to establish the conditions under which authorised investment firms and banks could provide specified services or establish branches in other Member States on the basis of home country authorisation and supervision, and the provision of services by third country firms in the Union is subject to national regimes and requirements (even if these firms do not enjoy the freedom to provide services and the right of establishment in Member States other than the one where they are established, as recalled in the recital 109 of the Directive 2014/65/EU).

On this legal base, we shall recast the view of British firms, because they have the same authorization to operate in the homeland and in Europe and, in the future, will be able to access to the markets of the remaining Member States only on the base of the agreement reached in the negotiation of Brexit or, whether there is not any settlement at EU level, on the base of a forthcoming bilateral

[61]See DICKINSON, *Back to the Future - The UK's EU Exit and the Conflict of Laws*, in *Oxford Legal Studies Research Paper*, No. 35/2016

[62]See SCHAMMO, *Home Country Control with Consent: A New Paradigm for Ensuring Trust and Cooperation in the Internal Market?*, in *Cambridge Yearbook of European Legal Studies*, Vol 15, 2012-2013 which aims at examining the building blocks of HCC-C in order to focus on a (mostly horizontal) supervisory arrangement which allows other (host) actors to get involved in the decision-making of a home country authority.

agreements between the United Kingdom and the relevant Member State.[63]

We cannot soften the negative judgement related to the aforesaid neither considering that a British company should set up a sub-holding in one Member State in order to obtain an EU authorization useful to operate cross-border within the Internal Market (and then useful to take advantage of the freedom to provide services and the right of establishment). This operative solution, in fact, does not get round the problems caused by the *discontinuity* related to the centralization of property rights in a company that is placed out of the Internal Market. In particular, this *discontinuity* does not fulfil the need for *unity* placed by the globalization of the financial market, as highlighted by the De Larosière Group in its report of 2009.[64]

Focusing our interest to the banking industry, we shall consider that the European regulators had been the sources of the uniform convergence to principles aimed to regulate credit institutions and the prudential supervision on them.[65] Even if most of these principles were settle at international level, in a perspective wider than the European territory (*i.e.* Basel Committee for Banking Supervision at Bank for International Settlements), we are aware of the option (made by Member States) to link the development of Internal Market resolved in the Single European Act (signed in Luxembourg on 17 February 1986 by the nine Member States and on 28 February 1986 by Denmark, Italy and Greece), and this since the First Basel Accord and Directive 89/646/EEC[66]).

Nowadays, the forthcoming CRD IV (*i.e.* Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institu-

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[63]See GOODHART - SCHOENMAKER, *The Global Investment Banks are Now All Becoming American: Does that Matter for Europeans?*, in *Journal of Financial Regulation*, Volume 2, Issue 2, 2016

[64]See MASERA, *La crisi globale: finanza, regolazione e vigilanza alla luce del rapporto de Larosiere*, in *Rivista Trimestrale di Diritto dell'Economia*, 2012, I, p. 147

[65]See DECARO, *Integrazione europea e diritto costituzionale*, in AA.VV, *Elementi di diritto pubblico dell'economia*, edited by Pellegrini, Padova, 2012, p. 59 ff.

[66]See ALEXANDER, *The International Supervisory Framework for Financial Services: An Emerging Regime for Transnational Supervision*, in *The Journal of International Banking Regulation*, 2000, p. 33 ff.

tions and investment firms) and CRR (*i.e.* Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms) pursue the objective of implementing a *risk-sensitive framework* able to harmonize the competitive approach of banks to their market,[67] in order to avoid any unsustainable form of competition (in lowering the quality of the business) that will jeopardize the quality of credit and then the safeguard of savings.[68]

Therefore, from an economical perspective, the exit of British credit institutions will produce - in addition to new costs for the authorization of their cross-border activity to the Internal Market[69] - another *inconsistency* in the European system of financial supervision.[70] And this becomes riskier if we consider also the exit from the European deposit guarantee scheme designed by Directive 2014/49/EU[71] (that is subject to Brexit negotiation, even if in the event of no settlement, we should consider the provision aimed to regulate the branches of credit institutions established in third countries, *ex* Article 15 of the aforesaid Directive 2014/49/EU).[72]

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[67]See AYADI - ARBAK - DE GROEN, *Implementing Basel III in Europe: Diagnosis and Avenues for Improvement*, in *CEPS Policy Brief*, No. 275/2012

[68]See XIAO, *Financial Stability in an Evolving Regulatory and Supervisory Landscape*, in *IMF Working Paper* No. 13/47, 2013 where the Author runs qualitative and quantitative analyses of the financial soundness of certain banks.

[69]We shall consider, in this case, the link between the power to authorize a firm and the reciprocal conditions for entities belonging system of a third country, under the European legislation on insurance, banking and finance. There is no doubt that this option was originally designed to meet two requirements: formal (administrative relations with non-EU entities are, in many cases, legally allocated to government bodies) and substantial (of 'knowledge' and evaluation, at inter-ministerial level, the entity that manifests the intent to enter the domestic credit market of a member State), see AMOROSINO, Commento sub art. 14 d. lgs. 385 del 1993, in VV.AA., *Commentario al testo unico delle leggi in materia bancaria e creditizi*, edited by Capriglione, Padova, 2012, p. 192 ff.

[70]See JOOSEN, *Further changes to the Capital Requirements Directive: CRD IV – major overhaul of the current European CRD legislation to adopt the Basel III Accord*, in *Journal of International Banking Law and Regulation*, 2012, p. 45 ff.

[71]Further consideration shall refer to the euro-area wide deposit insurance scheme (EDIS) for bank deposits and has set out further measures to reduce remaining risks in the banking sector in parallel; see Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, COM/2015/0586 final - 2015/0270 (COD).

[72]See GORDON - RINGE, *Bank Resolution in the European Banking Union: A Transatlantic Perspective on What it Would Take*, in *Columbia Law and Economics Working Paper*, No. 465/2014, and *Oxford Legal Studies Research Paper*, No. 18/2014

With regard to the asset management industry, we expect a deep impact of the Brexit because of its development on collective investment schemes mainly regulated at European level.[73] UCITS, AIF, EuVECA, EuSEF and ELTIF (in addition to the forthcoming MMF) are common schemes of undertakings and funds used by the EU regulators in order to avoid unsuitable act of *regulatory competition* concerning the quality of the management models (used for the implementation of the investment policies) and of the external relations (with the participants or with the subjects involved in the asset management). And the UK regulator comply to these schemes by applying 'an 'intelligent copy-out' approach', as explicitly mentioned with regard to the application of Directive 2014/91/EU (UCITS V)[74]. So, in this industry, the efficiency reached by EU regulators requires the fulfilment of the aforesaid uniformity (wanted by EU regulator in the set-up of bylaws required to establish any investment fund).[75]

We shall consider that the option for common schemes puts the competition in two dimensions: risk and expected return. Therefore, in absence of asymmetric regulations, the investment policy of the funds shall be comparable even if they have a different object, and then they will be the parameter to be used to understand the economic convenience of the return on risk offered by any asset manager. On the contrary, the possibility that British regulator shall provide *other* collective investment schemes bears on the individual participant the costs of an economic analysis of the regulatory structure of the fund. And this will affect the

[73]See LEMMA, *Collective portfolio management*, in VV.AA., *Italian banking and financial law*, edited by Siclari, London, 2015, p. 62 ff.
[74]See Financial Conduct Authority, *Policy Statement PS16/2, Implementation of the UCITS V Directive*, February 2016, p. 6 where it is also explained that 'this means that we adhere closely to the UCITS V wording when implementing relevant provisions in the Handbook, while using alternative wording where needed to align with UK law and practice. Although the UCITS Directive is a 'minimum harmonising' Directive, generally we decided not to impose additional requirements on firms beyond what is strictly required under UCITS V (subject to certain exceptions)'.
[75]See MCCAHERY - VERMEULEN, *Recasting Private Equity Funds after the Financial Crisis: The End of 'Two and Twenty' and the Emergence of Co-Investment and Separate Account Arrangements*, in *ECGI - Law Working Pape*r No. 231/2013.

capacity of the whole European industry to reach the market equilibrium that maximizes the investors' utility.

More in general, the new EU regulation of financial markets seems to be exposed to the risk of a competitive action made by British regulators, which - once it is out of the EU - can implement rules that are less expensive than those recently adopted by Directive 2014/65/EU (MiFID II) and Regulation (EU) 600/2014 (MiFIR),[76] even if it will bring to a less stable setting of the juridical place where demand and offering for financial instruments meet.[77] It is not by chance that Directive 2004/39/EC (MiFID I) set up a pervasive regulation of the trading venues while the European Union was developing the *élargissement*, by joining ten new Member States and, the, while the EU bodies were looking for an increase in the number of subjects able to exchange capital within a single market.[78]

All the above occurs at the same time of a growth in the EU economy, and some scholars read into this *coincidence* the confirmation of the efficiency of the aforesaid increasing in the number of Member States.[79]

We cannot deny the question about the effects of Brexit on the reliability of the markets and then about the possible decrease in the efficiency reached by the capital markets and the relevant mechanism for the circulation of wealth.[80] There is no doubt that the absolute freedom in financial exchange was not able to reach sustainable level of welfare, neither to maximize it (and that it is useful an exten-

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[76]In the research for high levels of resiliency, MiFID II and MiFIR have identified a set of rules aimed to internalize (in the balance sheets of the operators) the cost of an investors' protection system that is going to be more pervasive than the one previously in force; see the papers of RICCIUTO, CAPRIGLIONE and GUARRACINO, all in VV. AA., *La MiFID II. Rapporti con la clientela – regole di governance – mercati*, Padova 2016, edited by Troiano, p. 3 ff., p. 171 ff., and p. 231 ff.

[77]See POSNER, Economic analysis of law, New York, 2007, p. 480 ff.

[78]See FERRARINI - SAGUATO, *Regulating Financial Market Infrastructures*, in *ECGI - Law Working Paper*, No. 259/2014

[79]See *Considerazioni finali per l'anno 2005*, edited by Banca d'Italia, Roma, 2006, p. 5; before PRASAD-ROGOFF-WEI-KOSE, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence*, in *LMF Occasional Paper*, No. 220/2003

[80]See LARIONOVA - SHELEPOV, *Post-Brexit Britain: Its Relations with the EU and Its Future in the Framework of Multilateral Institutions*, in *Russian Economic Developments*, Moscow, 2016, No 7, p. 59 ff.

sive use of public intervention in order to adopt a specific juridical configuration of the markets for capital).[81]

Therefore, even from this viewpoint, we shall consider that, during the aforesaid negotiation provided by Article 50 of the Treaty on the European Union, UK and EU will take into account a specific clause concerning the compliance of British financial markets to the standard of public supervision provided by EU regulators and, at the same time, the possibility to remain interconnected with the Internal Market set up by MiFID and MiFIR.[82]

Despite this, in the context of Brexit, the principle 'capital markets are competitive, and competitive markets generate information about the products sold' - stated by Posner[83] - arises specific doubt on the effects of a possible misalignment in the provision of disclosure duties (in one or the other market).

Hence, there is the need to evaluate the option (of the British Government and Parliament) related both to the implementation of to the normative contents of the various European directive on the quality of financial information (*i.e.* no. 2003/71/CE, no. 2004/25/CE, etc.), and the safeguard of the common framework for the stability, transparency and efficiency of the EU market for financial instruments, as key element for a safer and sounder regulatory framework for European financial network, provided by Regulation (EU) no. 648/2012, on OTC derivatives, central counterparties and trade repositories (EMIR).[84]

The same conclusion concerns the risk that British market will not able to manage the speculation. Even if speculative action can be useful in adjusting the relevant prices (and reaching specific points of equilibrium), it can reduce the investor's trust and then misalign market trends from the values accounted in the

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[81] See MONTEDORO, *Attualità di Carl Schmitt nella lettura di Giannini e Nigro*, in *www. giustizia-amministrativa.it*

[82] See SEPE, *La Mifid II e i mercati*, in VV. AA., *La MiFID II. Rapporti con la clientela – regole di governance – mercati*, cit., p. 265 ff.

[83] See POSNER, *Economic analysis of law*, New York, 2007, p. 481

[84] See *Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories*, COM/2010/0484 final - COD 2010 /0250

real economy. Hence, there is the need for monitoring the British approach to the rules provided by the Regulation (EU) no. 236/2012 on short selling.

All the aforesaid regulations rely on the new European System of Financial Supervision (ESFS).[85] This is the reason for calling to mind several works that, confirming the thesis of the De Larosière Group, find out that the leading role of national authorities was a limit for the proper functioning of the public control, because their powers were limit by the national territory,[86] and then unable to satisfy the need of protection due to the macro-prudential risks of financial globalization (and the related effect of contagion).[87]

So, Brexit calls the ESFS to support one of the most expensive tasks. This system shall face the uncertainty, being able to support the efficient execution of the actions aimed to verify the compliance of any financial operation able to produce its effect within the Internal Market (even if they mainly belong to the British legal order). We refer, in particular, to the effect of the operation that merged London Stock Exchange, Borsa Italiana and Deutsche Börse, by establishing an 'UK TopCo holding company'.[88] Such agglomerate of interest, indeed, place the head-

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[85]See WYMEERSCH, *The Institutional Reforms of the European Financial Supervisory System, an Interim Report*, in *Ghent Univ. Financial Law Institute Working Paper*, No. 1/2010.

[86]See, among others, FERRARINI - CHIARELLA, *Common Banking Supervision in the Eurozone Strengths and Weaknesses*, in *ECGI - Law Working Paper*, No. 223/2013.

[87]On this point, comes to mind the opening of the Schulman Declaration of 9 May 1950: 'World peace cannot be safeguarded without the making of creative efforts proportionate to the dangers which threaten it'.

The same will underlies the creation of the ESFS, suitable for the supranational dimension of the risks that characterize the cross-border operation of the economy and finance.

And even in this part of the coming together of the nations of Europe it was the contribution which an organized and living Europe can bring to civilization is indispensable to the maintenance of peaceful relations. Also in this case with a strategy that was able to be taken immediately on one limited but decisive point (not coal and steel that in the postwar period made reference to the CECA, but banks, securities and financial markets, insurance and pensions, which are now subject to EBA, ESMA and EIOPA).

[88]See Deutsche Borse AG, *Final results of exchange offer*, 17 August 2016. Furthermore, according to LSEG Document of 1 June 2016, named 'Recommended all-share merger between London Stock Exchange Group Plc and Deutsche Börse Ag - Publication of scheme document, exchange offer document and holdco prospectus', the merger will be implemented through a new UK TopCo holding company (so called HoldCo) which has been incorporated in the UK, resident solely in the UK for tax purposes and with a board of directors constituted in accordance with the UK Corporate Governance Code. HoldCo will acquire LSEG by way of a scheme of arrangement

quarters in the United Kingdom and outside the territory of the forthcoming EU. This extends the scope of the ESFS (and of its supervising authorities) to (British) subjects that are going to be *extraneous* (or rather *stranger*) to the EU legal order (and the relevant powers of intervention).[89] Hence, there is a specific question that should be addressed in the negotiation in order to avoid inefficient disputes due to the British autonomous jurisdiction arising from Brexit).

Concluding on this point, we shall assess the effects of an unsuccessful closing of the negotiation provided by Article 50 and then of the absence of any settlement between UK an EU. This will imply that the Brexit negotiators would have not reached an equilibrium able to keep the results obtained since the Single European Act.[90]

Therefore, EU bodies shall not perform only specific controls on the actual set up of British legal order (and on the state of the British rules due to EU sources), but shall also adopt specific measure in order to avoid that British markets will be the breeding ground of systemic risks able to infect the Internal Market (and this also because the British nationality of the market operator that manages British, Italian and German regulated markets).[91]

Externalities of the Brexit are, then, the most difficult elements to account in computing the total utility of the agreements that can be reached by the negotiation between UK and EU, and then by bilateral relationships among UK and each Member State. Furthermore, this computation shall consider the financial innovation and its effects in terms of increasing complexity and velocity. There is no doubt that, up to date, we can register orderly market trends (even if placed in a negative section of the relevant chart),[92] because both the possibility that they

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of LSEG and will acquire Deutsche Börse by making a securities exchange offer to all shareholders of Deutsche Börse.

[89]See BUTTIGIEG, *Governance of Securities Regulation and Supervision: Quo Vadis Europa?*, in *Columbia Journal of European Law*, Vol. 21, 2015, p. 411 ff.

[90]See NAPOLITANO Giorgio, *Brexit e spinta al cambiamento*, in *IlSole24Ore.com*, 7 July 2016.

[91]See Deutsche Borse AG, *Final results of exchange offer*, 17 August 2016

[92]See DG/MARKET OPERATIONS, *Bond Market Contact Group Ad-hoc teleconference*, Frankfurt am Main, 27 June 2016, about the impact on euro area bond markets of the outcome of the

had already anticipated the hypothesis of Brexit,[93] and the monetary action placed by Bank of England in order to minimize the volatility of financial markets.[94]

However, something remains to be seen. It is the final result of the Brexit and the concrete content of the agreements resulting from the withdrawal.

All the above recalls the 'robust contingency plans for the immediate financial aftermath in the event of this result' (*i.e.* the Brexit), implemented by the relevant British authorities (*i.e.* Treasury, the Bank of England, and the Financial Conduct Authority, etc.) [95] and, in particular, the introduction of safeguards aimed to protect the safe and sound management of the most important financial firms (made by the Prudential Regulation Authority).[96] Meaningful, on this point, is the statement made by the Chancellor of the Exchequer: 'You should not underestimate our resolve. We were prepared for the unexpected. We are equipped for whatever happens. And we are determined that unlike eight years ago, Britain's financial system will help our country deal with any shocks and dampen them - not contribute to those shocks or make them worse'.[97]

7. Consent (of the governed) and safeguard of rights (arising from the

UK's referendum on EU membership where the members described the bond market reaction as orderly, with no panic in the markets, noting that Euro area bond market liquidity had declined post-Brexit vote.

[93]See GARZARELLI, *Macro Rate Markets Outlook*, in *Global Macro-Markets Research and of European Economics, (Goldman Sachs International)*, Frankfurt, 7 April 2016, p. 11 ff.

[94]See *Financial Stability Report*, edited by Bank Of England July 2016

[95]See *Statement* by the Chancellor of the Exchequer, George Osborne following the outcome of the EU referendum, HM Treasury and The Rt Hon George Osborne, 27 June 2016 and, in particular, that 'Swap lines were arranged in advance so the Bank of England is now able to lend in foreign currency if needed. As part of those plans, the Bank and we agreed that there would be an immediate statement on Friday morning from the Governor, Mark Carney. As Mark made clear, the Bank of England stands ready to provide £250 billion of funds, through its normal facilities, to continue to support banks and the smooth functioning of markets'. See MINENNA, *Brexit: la Bank of England si muove. Le prospettive future della politica monetaria britannica e gli impatti sull'Europa*, available on *dirittobancario.it*

[96]See *Speech* by Martin Weale, *Brexit and Monetary Policy*, Given at Resolution Foundation, London, 18 July 2016 where it is stated that 'The assumption in markets is that the Committee will respond to Brexit not just by holding the Bank Rate fixed for longer than would otherwise have been the case, but by reducing it sharply'.

[97]See *Statement* by the Chancellor of the Exchequer, George Osborne following the outcome of the EU referendum, cit.

European integration process) are specific limits to the actions taken by the British Government to enact the Brexit.

The role of the EU bodies in this grievous sequence of events will depend on the way they will use the powers granted by the European Treaties to negotiate an exit wanted by the majority of a Member State. This requires also the setting of the role of the British Government, which shall realize the will of the subjects of Her Majesty the Queen by respecting the rights of the remaining European citizens (and, in the same context, the ones of the whole international community).

Consequently, the efficiency of the Brexit requires the safe and sound use of the powers of the negotiating parties, and then a democratic and effective path for the withdrawal.[98] In other words, the preference for a competitive approach (made by both the United Kingdom or the European Union) to this negotiation shall not comply with the type of national relationship developed after the end of the 'Short twentieth century'. And this becomes clearer if we consider the need for the safeguard of the economic freedoms of individuals. Whereby, we shall consider the *horizontal accountability* of National Governments, given the community of interests existing among the members of the 'Group of Seven' (concerning, in brief, the need for the orderly free trade and the enforceability of rules and obligations, both considered as essential elements for the development of a globalized and financialized economy).[99]

All the above means that British Government shall fulfil the duty to minimize the administrative and transactional costs of exiting the UK, whereby obvious reasons of economic convenience will push the one (UK) and the other (EU) to avoid barriers between British and European markets. Hence, it is clear the social

[98]See LANG, *The Consequences of Brexit: Some Complications From International Law*, in *LSE Law Policy Briefing Series*, No. 3/2014

[99]Not by chance, under the above analysis, lies the idea that not only economic development, but also the stability (of intermediaries), the order (of the markets) and safety (of capital) are closely interdependent and jointly influenced by the quality of relations between states, as recent economic analyzes show.

utility arising from the recovery of any form of harmonization of both British and European rules, in order to keep adequate level of integration in the trading venues, whether the latter is within the EU or not (*i.e.* British).

This is the directions provided by British Prime Minister, David Cameron, in his statement, made soon after the results of the referendum: 'I was absolutely clear about my belief that Britain is stronger, safer and better off inside the European Union … I would reassure those markets and investors that Britain's economy is fundamentally strong'. And this is compliant with the statement made by the Chancellor of the Exchequer, George Osborne following the outcome of the EU referendum: 'Britain is ready to confront what the future holds for us from a position of strength … The … challenge [is] that of ensuring that Britain was able to agree a long-term economic relationship with the rest of Europe that provided for the best possible terms of trade in goods and services. Together, my colleagues in the government, the Conservative Party and in Parliament will have to determine what those terms should be – and we'll have to negotiate with our European friends to agree them'[100]. Hence, the univocal words of the British Prime Minister, Theresa May: 'We voted to leave … and I certainly will make sure now that the Government does what the people asked it to do'.[101]

Concluding remarks must concern the contemporaneity of the following statement, quoted from the 1946's 'Manifesto di Ventotene': 'In the brief, intense period of general crisis (when the States will lie broken, when the masses will be anxiously waiting for a new message, like molten matter, burning, and easily shaped into new moulds capable of accommodating the guidance of serious internationalist minded men), the most privileged classes in the old national systems

[100]See *Statement* by the Chancellor of the Exchequer, George Osborne following the outcome of the EU referendum; HM Treasury and The Rt Hon George Osborne, 27 June 2016
[101]See COWBURN, *Theresa May tells Lords to 'get behind Brexit' after threat to derail Article 50 plans*, in *The Indipendent*, 1 August 2016

will attempt, by underhand or violent methods, to dampen the wave of internationalist feelings and passions and will ostentatiously begin to reconstruct the old State institutions. Most probably, the British leaders, perhaps in agreement with the Americans, will try to push things in this direction, in order to restore balance-of-power politics, in the apparent immediate interests of their empires'.[102]

[102]See SPINELLI - ROSSI - COLORNI, *Per un'Europa libera e unita*, Ventotene (LT), August 1941

REGULATING GLOBAL FINANCE: THE EU BENCHMARKS REGULATION AS A 'BENCHMARK'? A POLITICAL READING

Simon Janin* – Carla Stamegna**

ABSTRACT: *The price of many financial instruments, as well as the value of various financial contracts depend on benchmarks. In recent years benchmarks have drawn great attention from the public and regulators, because of their alleged manipulations and the subsequent negative impact on investors' confidence, market integrity and financial stability as a whole. Interbank reference rates, such as LIBOR, EURIBOR and TIBOR, were the most apparent cases, but suspicions of manipulations also arose for commodity and FX benchmarks. The first action to remove the benchmark-setting process weaknesses was taken by the industry, but proved insufficient. Market participants themselves called therefore for a regulatory response to restore the integrity of benchmarks and the investors' confidence, and had a say on what a regulatory framework should have looked like. The industry workstream went hand in hand with the regulatory response. Regulators initially decided to adopt a soft-law approach encouraging, rather than imposing, new rules addressing a field of financial activity which had never been regulated before then. That was the case also for the Principles laid down by the IOSCO in July 2013, which have become the cornerstone of benchmarks regulation at international level. The European Union was the first jurisdiction to adopt a binding overarching regime for producing and using financial benchmarks. The initial Commission's proposal went beyond the IOSCO Principles both in form and in substance, adopting a one-size-fits-all approach, staring more stringent requirements for 'critical' benchmarks and setting out a full-fledged equivalence regime for third*

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* Financial Services attaché at the Permanent Representation of France to the EU.

** Financial Services attaché at the Permanent Representation of Italy to the EU.

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countries. European co-legislators however pushed for a realignment with the international standards and introduced more proportionality and a more flexible outcome-based third country regime. In parallel with the international regulatory workstreams and even before the European Union adopted its overarching legislation on financial benchmarks, the United Kingdom had launched an autonomous reform of the sector, based on the Wheatley Review of LIBOR. The new UK legislation covered only seven indexes and was to be replaced by the European Regulation. Following the referendum on Brexit that could not be the case anymore. Nonetheless a substantial compliance with EU rules is expected to be maintained, in order to grant the equivalence of the national scheme to the European one. The UK is likely not to be the only (possible) third country to calibrate its own legislation on the EU framework, since the IOSCO is considering to adopt the EU approach to lay down a proportional regime under its Principles. The European Regulation seems therefore likely to become 'the benchmark' of the international benchmark regulatory framework, reversing the consolidated rule maker-rule taker relationship between global standard setters and single jurisdictions. Both EU and UK should draw general lessons from the restricted example of the Benchmarks Regulation.

SUMMARY: 1. Introduction. - 2. LIBOR and EURIBOR scandals. - 3. Actions taken by the industry. - 4. The international regulatory framework. - 5. The original European Commission's proposal: rationale and main features. - 6. The co-legislative process and the substantial amendments introduced by the European co-legislators: more proportionality, a completely new third country regime. - 7. The United Kingdom's own reform and Brexit. - 8. Conclusions.

1. The price of many financial instruments (such as bonds and derivatives), as well as the value of various financial contracts (such as mortgages or consumer credit) depend on indexes. Also the performance of investment funds (e.g. UCITS) is often measured through indexes acting as a reference both for tracking the return of such funds, and for defining their best asset allocation. An index is a meas-

ure synthetically representing a set of underlying data and related changes. When an index is used as a parameter for determining the value of a financial instrument or contract, as well as to measure the performance of a fund, it becomes a benchmark. In recent years benchmarks have drawn great attention from the public and regulators, because of their alleged manipulations and the subsequent negative impact on investors' confidence, market integrity and financial stability as a whole.

2. Interbank reference rates hit to headlines first. In April 2008, a controversial article published in the Wall Street Journal[1] and a subsequent study by the same newspaper[2], questioned the reliability of LIBOR[3], suggesting that some banks participating in the panel of contributors had deliberately underestimated the cost of funding indicated for calculation purpose, in order to positively influence their perceived counterparty risk during the turmoil affecting the interbank market in the subprime crisis of 2008.

A study by Snider and Youle in April 2010[4] supported such an hypothesis. Unlike the study of the Wall Street Journal, however, it suggested that the manipulation was based on the agreed pre-determination of the index by some contributor banks, purposely intended to reap undue profits on their large LIBOR-indexed derivatives exposures.

Because LIBOR is widely used on US derivatives markets, its possible manipulation would constitute a *de facto* manipulation of these markets and, therefore, a violation of US law. In addition, since LIBOR is referenced in mortgages,

[1]See MOLLENKAMP (2008), *Bankers Cast Doubt On Key Rate Amid Crisis*, The Wall Street Journal, 16 April.

[2]See MOLLENKAMP – WHITEHOUSE (2008) , *Study Casts Doubt on Key Rate*, The Wall Street Journal, 29 May.

[3]Short for London Interbank Offered Rate, a benchmark rate produced for five currencies with seven maturities quoted for each - ranging from overnight to 12 months, producing 35 rates each business day.LIBOR provides an indication of the average rate at which a LIBOR contributor bank can obtain unsecured funding in the London interbank market for a given period, in a given currency. Individual LIBOR rates are the end-product of a calculation based upon submissions from LIBOR contributor banks. (Definition by ICE LIBOR).

[4]See SNIDER – YOULE (2010), *Does the LIBOR Reflect Banks' Borrowing Costs?*, 2 April.

other consumer credit contracts and several financial products, the manipulation of its input data could have significant negative effects on consumers and financial markets all over the world.

On the basis of these considerations, the supervisory authorities of United States (US Commodity Futures Trading Commission, CFTC), Japan (Japan Financial Services Agency, JFSA), United Kingdom (Financial Services Authority, FSA, then transformed in Financial Conduct Authority, FCA), the European Commission and the US Department of Justice opened investigations to check whether, between 2006 and 2008, the sixteen major contributors of LIBOR had actually made a cartel for manipulation purpose. In late 2011 the European Commission started an investigation[5] for suspected violation of antitrust rules and anti-competitive practices also against some contributors of the EURIBOR[6]. In February 2012 the Swiss antitrust authority (the Competition Authority) launched an investigation against two major Swiss banks (Credit Suisse and UBS) and ten foreign banks to establish whether arrangements had been put in place to influence LIBOR and TIBOR[7] in order to unduly increase the profitability of certain derivative transactions[8]. The Authority of Singapore[9] finally joined the list.

The scale of scandals became apparent in June 2012, when the FSA, the CFTC and the US Department of Justice jointly imposed a 290 million pound fine (approximately 490 million dollars) to Barclays, for alleged manipulation of reference rates. This first fine triggered many other actions against several credit insti-

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[5]See CELLINO (2011), *Istituti nel mirino dell'Ue per l'EURIBOR,* Il Sole 24 Ore, 20 October
[6]Short for Euro Interbank Offered Rate, the rates offered to prime banks on euro interbank term deposits. The EURIBOR is based on average interest rates established by a panel of currently 21 European banks (panel banks) that lend and borrow from each other. Loan maturities vary from a week to a year and their rates are considered among the most important in the European money market.
[7]Short for Tokyo Interbank Offered Rate.
[8]See TERLIZZI (2012a), *Usb e Credit Suisse sotto inchiesta sul LIBOR*. Il Sole 24 Ore, 4 February
[9]See VAUGHAN (2013), *Singapore Censures 20 Banks Over Rates*, The Wall Street Journal, 15 June.

tutions operating on a global scale[10], as well as a number of lawsuits in the United States and Europe brought by investors damaged by altered rates.

Between late 2012 and 2014 suspicions of manipulation of benchmarks used for commodity pricing, in particular gold[11], silver[12] and electricity[13], arose as well and triggered various investigations, notably by the European Commission who led several raids in oil majors in an investigation into the setting of oil prices[14]. Doubts of manipulation, finally, affected also indexes used as a reference in the foreign exchange market[15].

Not only did the results of all these investigations highlight the importance of benchmarks for the proper functioning of financial markets, they also shown the numerous weaknesses affecting the benchmark-setting process and the use of indexes, as well as the scope of their potential manipulations.

3. The first action to remove such weaknesses was taken by the industry. A few days after the release of the Wall Street Journal piece on the alleged manipu-

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[10]The following is a non-exhaustive list of measures taken by the various authorities: US Commodity Futures Trading Commission (CFTC) Order against Cooperatieve Centrale Raiffeisen -Boerenleenbank B.A. ("Rabobank") (29 October 2013); Japan Financial Services Agency (JFSA) administrative action against RBS Securities Japan Limited (12 April 2013); US Commodity Futures Trading Commission (CFTC) Order against Royal Bank of Scotland plc and RBS Securities Japan Limited (6 February 2013); US Commodity Futures Trading Commission (CFTC) Order against UBS AG and UBS Securities Japan Co. Ltd (19 December 2012); UK Financial Services Authority (FSA) sanctions against UBS AG (19 December 2012); Swiss Financial Market Supervisory Authority (FINMA) order against UBS AG (19 December 2012); US CFTC Order against Barclays PLC, Barclays Bank PLC and Barclays Capital Inc. (27 June 2012); UK FSA sanctions against Barclays Bank PLC (27 June 2012); JFSA administrative action against UBS Securities Japan Ltd and UBS AG, Japan branches, (16 December 2011); JFSA administrative action against Citigroup Global Market Japan Inc. (16 December 2011); JFSA administrative action against Citibank Japan Ltd. (16 December 2011).

[11]See BELLOMO (2014), *Il fixing dell'oro è stato manipolato – Multa a Barclays*, Il Sole 24 Ore, 24 May.

[12]See BELLOMO (2014b), *Argento, addio al fixing dal giorno di Ferragosto*, Il Sole 24 Ore, 15 May.

[13]See VALSANIA (2013), JP Morgan, nuova inchiesta negli Usa, Il Sole 24 Ore, 4 May

[14]In May 2013, DG COMP raided oil majors Royal Dutch Shell, BP and Statoil. The European Commission argued at that time that "companies may have colluded in reporting distorted prices to a price-reporting agency to manipulate the published prices", adding that it had concerns that "companies may have prevented others from participating in the price assessment process, with a view to distorting published prices".

[15]See MAISANO (2013), *Londra «trema» sui cambi manipolati*, Il Sole 24 Ore, 13 June; MAISANO (2014), *Boe: «Lo scandalo Forex più grave di quello del Libor»*, Il Sole 24 Ore, 12 March.

lation of LIBOR, the British Bankers' Association (BBA), administrator of the benchmark, said the index would have been amended to take into account market developments. Market operators expected the panel to be expanded or a new index introduced, however on May 2008 the BBA announced that neither the panel nor the index would have changed, but rather the independent committee of control (Foreign Exchange and Money Markets Committee) would put in place more stringent checks to prevent misalignment between official and charged rates. The following December the BBA introduced also some governance changes, including the creation of two sub-committees for control and setting of rates, and decided to expand the number of the Foreign Exchange and Money Markets Committee members, adding some banks which was not included in the contributors' panel as well as further independent entities[16]. In light of the offences committed in the following years, however, these measures proved insufficient.

Markets themselves therefore called for a regulatory response to restore the integrity of benchmarks and the investors' confidence, but had a say on what a regulatory framework should have looked like. The initiative of the Global Financial Markets Association (GFMA) of 2012 does matter in this respect, which resulted in the publication of a set of principles[17] to be taken into account by regulators when designing a relevant regime. These principles were based on four pillars: systemic importance of indexes, proportionality, strengthened regime also for not-supervised entities and coordination at supranational level so as to ensure that rules are applied consistently among the various jurisdictions.

The Code for Independent Price Reporting Organizations (IPROs)[18], elaborated by Argus Media, ICIS and Platts[19], deserves also to be mentioned: it was a

[16]See British Bankers' Association (2014), BBA Libor Report, June.

[17]See Global Financial Markets Association (2012), *Principles for Financial Benchmarks*, September; - (2012) *Updated Principles for Financial Benchmarks*, November.

[18]Independent Price Reporting Organisations (IPROs) are news and information publishers whose editorial activities include reporting on commodities markets and providing price assessments for those markets on a commercial basis.

[19]See ARGUS MEDIA, ICIS, PLATTS (2012), *The Price Reporting Code For Independent Price Reporting Organisations*, October.

sectorial piece of self-regulation comprised of a number of standards and industry guidance focused on maintaining a robust governance, managing and mitigating conflicts of interest and enhancing the integrity and transparency of price reporting.

4. The industry workstreams went hand in hand with the regulatory response, which was not slow in coming. Regulators initially decided to adopt a soft-law approach aimed at encouraging, rather than imposing, rules addressing a field of financial activity which had never been regulated before then.

In October 2012, the International Organization of Securities Commissions (IOSCO) published a set of principles[20] designed for Oil Price Reporting Agencies (PRAs), intended to boost the reliability of oil prices assessments that are referenced in derivative contracts subject to regulation by the IOSCO members. The principles detail a series of recommended good practices for PRAs, concerning the price evaluation methodology, the quality of data, the quality control procedures, the conflict of interest mitigation and the cooperation with supervisory authorities. IOSCO recommends market authorities to consider whether to prohibit negotiations of commodity derivatives indexed to price assessments which are not carried out by PRAs according to the proposed principles.

At the end of 2012, following suspicions of manipulation of interest rate benchmarks, the European Supervisory Authorities (European Banking Authority, EBA, and European securities and Markets Authority, ESMA) carried out an analysis that identified a number of weaknesses and problems in the production and dissemination of EURIBOR and made a start on its reform. EBA and ESMA namely

[20] See IOSCO (2012), *Principles for Oil Price Reporting Agencies*, 5 October. This report builds upon issues that were identified in Oil Price Reporting Agencies, the joint report of the International Energy Forum (IEF), International Energy Agency (IEA), Organization of Petroleum Exporting Countries (OPEC) and IOSCO, published in October 2011. It also has been informed by the comments received in response to IOSCO's March 2012 Consultation Paper Functioning and Oversight of Oil Price Reporting Agencies, as well as discussions and comment by the international organizations at key points. .

issued specific recommendations[21] concerning the governance of the EURIBOR administrator (originally Euribor-EBF, then EMMI), the role of the Steering Committee, the maturity and the panel members. The EBF gave a quick positive response[22] to the authorities' recommendations, integrating them with further changes which included: (i) the reduction of board members appointed by the panel banks (four out ten) and the inclusion of other types of stakeholders, so as to increase the independence and diversity of the body; (ii) the decision that, as of November 1, 2013, the EURIBOR would be calculated and published only for maturities of 1 and 2 weeks and 1, 2, 3, 6, 9 and 12 months; (iii) the publication of the new Corporate Code effective as of October 1, 2013, designed according to the recommendations provided by the European Authorities. The benefits from these changes, however, were partially offset by the reduction in the number of contributors, partly due to M&A operations, partly to the decision to leave the panel assumed because of the scandals and the concerns about possible additional burden brought about by the regulation in progress. From 43 banks that made up the panel in September 2012, we have arrived today at 21. This has undermined one of the main EURIBOR strengths compared with LIBOR, i.e. the wider size of the panel.

The interest rate benchmarks was also dealt with by the Bank for International Settlements (BIS) in a report summarizing the central banks point of view[23].

In parallel with the EURIBOR reform, ESMA and EBA recognized the large number and spectrum of different benchmarks and the importance that all of them cover for market integrity and financial stability. In June 2013 they published a set of principles[24] aimed at improving the setting process of all benchmarks referenced in contracts and financial instruments negotiated within the European

[21]See EBA-ESMA (2013), *Report on the administration and management of EURIBOR*, 11 January

[22]See EBA-ESMA (2014), *Review of the Implementation of EBA-ESMA Recommendations to EURIBOR-EBF*, 20 February.

[23]See Bank for International Settlements (2013), *Towards better reference rate practices: a central bank perspective*, 18 March.

[24]See EBA-ESMA (2013), *Principles for Benchmark-Setting Processes in the EU*, 6 June.

Union. The principles are designed to provide administrators, calculation agents, contributors and users of different kind of benchmarks with a common framework for carrying out their activities.

An overarching reform at a global level was fostered, at the instigation of the G20, by the Financial Stability Board (FSB) through a broad workstream[25] focused on indices used as reference for interest rates (interest rate benchmarks, IRB) and in the foreign exchange market (FX benchmarks).

As part of its work in this area, the FSB has endorsed the Principles for Financial Benchmarks developed by IOSCO in July 2013[26], which have become the cornerstone of benchmarks regulation. The principles aim to create a general framework for enhancing the integrity, reliability and supervision of benchmarks used in financial markets all over the world, covering issues such as:

- Governance: according to the principles, the responsibility for the benchmark-setting process should be retained by administrators, in order to preserve its integrity. Administrators are also required to perform an oversight function on third parties undertaking activities related to benchmarks, by signing appropriate agreements. To limit the vulnerability of the process, that may incentivize the manipulation of indexes, administrators are recommended to take measures to monitor, manage and minimize conflicts of interest, to report them to stakeholders and authorities and to set up an adequate internal control system;
- Quality of benchmarks: the principles state that indices must be designed to credibly reflect the underlying economic reality. To this end administrators are recommended to verify that input data is sufficient and the calculation

[25]See FSB (2013), *Progress Report on the Oversight and Governance Framework for Financial Benchmark Reform*, 29 August; - (2014), *Foreign Exchange Benchmarks*, 15 July; - (2014), *Final Report of the Market Participants Group on Reforming Interest Rate Benchmarks*, 22 July; - (2014), *Review of the Implementation of IOSCO's Principles for Financial Benchmarks by Administrators of EURIBOR, LIBOR, TIBOR*, 22 July; - (2014), *Reforming Major Interest Rate Benchmarks*, 22 July; - (2014), *Final Report on Foreign Exchange Benchmarks*, 30 September; - (2015), *Progress in Reforming Major Interest Rate Benchmarks – Interim Report*, 9 July; - (2015), *Foreign Exchange Benchmarks: Report on progress in implementing the September 2014 recommendations*, 1 October; - (2015), *Measures to reduce misconduct risk*, 6 November; - (2016), Reforming Major Interest Rate Benchmarks, 19 July.

[26]See IOSCO (2013), *Principles for Financial Benchmarks*, 17 July.

methodology transparent, particularly with respect to the hierarchy of different sources;

- Quality of the Methodology: the principles set out minimum information that should be addressed within the methodology used by administrators for the index calculation. They also state that administrators should have credible policies in case a benchmark ceases to exist or stakeholders need to switch to a different benchmark. Finally, for indexes based on data provided by third parties, administrators are recommended to develop guidelines, in the form of codes of conduct, for all submitters. These guidelines should be available to regulatory authorities, where they exist, and/or to stakeholders;

- Accountability: the principles establish complaints mechanisms and provide for standard documentation and verifications carried out by auditors proving that administrators comply with the quality standards laid down by the principles and by themselves.

The IOSCO Principles are to be understood as a set of good practices whose implementation is recommended to benchmark administrators and contributors. They are designed to suit the size and specific risk of each benchmark, administrator or process, on the basis of a proportional approach. Beyond a set of general principles, in fact, a subset of more detailed principles is offered for benchmarks presenting specific risks due to the contributors' discretion in data setting and/or the administrator's proprietary structure.

The majority of IOSCO members did not use to regulate benchmark administrators or contributors at the time the Principles were published. Nonetheless, IOSCO members were invited to consider whether regulatory action may be appropriate to encourage implementation of the Principles. IOSCO planned to review, within a 18 month-period after the publication, to what extent the Principles, including those for PRAs, would have been implemented, on the basis of inputs from stakeholders, market authorities and, if appropriate, administrators themselves.

5. The European Union was the first jurisdiction to adopt a binding over-arching regime for producing and using financial benchmarks. The European Commission's initial response to the manipulation of LIBOR and EURIBOR consisted in amending the existing proposal for a regulation on market abuse (Market Abuse Regulation, MAR) and a related directive on applicable criminal sanctions (Criminal Sanctions for Market Abuse Directive, CSMAD), both adopted in 2014[27]. The amendments were intended to clarify that any manipulation of benchmarks is an offense and therefore it is liable to administrative or criminal sanctions. The mere modification of the sanctioning regime, however, would not improve the way benchmarks are produced and used, since it would not eliminate the risks related to the inadequate governance of the benchmark-setting process often affected by conflicts of interest and discretion.

On September 18, 2013, the European Commission adopted a specific proposal[28] for a regulation on financial benchmarks. The proposal was aimed not only to dispel new manipulations, but also to enhance the benchmark industry transparency and the investor protection by ensuring that benchmarks produced and used in the EU are robust, reliable, representative and fit for purpose. That arose in the context of the massive regulatory intervention enabled by the European Commission in the period 2009-2014 to promote an overall improvement of efficiency and transparency of European financial markets after the crisis which had severely affected them in previous years.

The initial Commission's proposal laid down a set of harmonized rules applicable to all published benchmarks (including commodity benchmarks) used as a

[27]See Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC; Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive).

[28]See European Commissione, (2013), *Proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts, Brussels* - COM(2013) 641 final, 18 September.

reference for financial instruments or financial contracts, as well as for measuring the performance of investment funds. Rules were focused on the benchmark setting process and use within the European Union and were mainly directed at individuals or legal entities having control over the provision of benchmarks ('administrators') as well as to entities providing input data for their calculation ('contributors'). The scope was defined on the basis of a subjective criterion, in analogy with the approach adopted some years earlier for credit rating agencies[29], as benchmarks in use in the Union are very numerous, while administrators and contributors are fewer. Members of the European System of Central Banks (ESCB) and central banks of third countries whose legal framework would be recognized as equivalent by the European Commission were in any case excluded from the scope. As shown in detail below, the broad scope and a one-size-fits-all approach chosen by the Commission were among the most controversial elements of the proposal.

Most of the contents of the Commission's proposal are taken from the IOSCO Principles of 2013, recognized as international standards. This is the case, for instance, for measures aimed to enhance governance and controls in benchmark setting (Articles 5 and 6); improve the quality of input data and methodologies, including the use of sufficient and accurate data (Article 7); limit and manage possible conflicts of interest at benchmark providers and contributors (Articles 9 and 11); ensure adequate protection for investors and consumers through improved transparency and suitability assessments (Articles 15-18). By issuing a regulation (rather than a directive) and establishing an enforcement regime, though, the European Commission chose to attach uniform and binding effects to the framework set out at international level. In so doing, the original international regulator' soft-law approach turned into hard law. Interestingly, this objective was pursued through a legislative technique based on the distinction between directly

[29] See Regulation (EU) No 513/2011 of the European Parliament and of the Council of 11 May 2011 amending Regulation (EC) No 1060/2009 on credit rating agencies.

applicable provisions and likewise binding rules contained in codes of conducts to be drafted by the same entities the Regulation was addressed to, on the basis of general terms developed by the European Commission by means of delegated acts (Art . 9).

The Commission's proposal went beyond the IOSCO Principles even in substance. First of all, as mentioned above, its provisions would apply across-the-board to all benchmarks referenced in financial instruments. A proportional application was not envisaged; rather more stringent requirements were stared for administrators of benchmark having a 'critical'[30] role in financial markets. Namely, a mandatory contribution regime for critical benchmark submitters was laid down, in order to prevent them to discretionally leave the panel, as it was the case for EURIBOR panel banks a few years earlier. Furthermore, the establishment of colleges of supervisors was imposed for critical benchmarks, in order to improve the exchange of information and ensure uniformity of action among the authorities concerned.

Secondly, the proposed Regulation provided that EU supervised entities would be allowed to use benchmarks produced by administrators located in third countries only if the relevant legal framework was deemed equivalent to the EU one by a separate Commission’s decision (‘full-fledged third countries regime’). The third country regime proved another very controversial issue, given the fact that when the proposal was adopted there was no other jurisdiction all over the world that had implemented an equivalent regime.

According to the Commission’s proposal, once adopted the Regulation

[30]In the initial Commission’s proposal ‘critical’ benchmarks are defined on the basis of a purely quantitative criterion. Under Art. 3 (21) a ‘critical benchmark’ means a benchmark the majority of contributors to which are supervised entities and that reference financial instruments having a notional value of at least 500 billion euro. This definition was broadly debated during the negotiations leading to the adoption of the final text of the Regulation. The purely quantitative criterion chosen by the Commission, in fact, was deemed difficult to apply because of the lack of exhaustive data on referenced instruments and, in any case, not sufficiently indicative of the critical role that some indices cover for the functioning of financial markets. This definition was modified by the co-legislators in the wake of negotiations so that in the final version of the Regulation the combined use of quantitative and qualitative criteria is envisaged (Art. 20).

would enter into force on the day following its publication in the EU Official Journal and would be directly applicable after a period of 12 months. In most parts the proposal was referring to second-level measures, in the form of delegated acts by the European Commission and/or ESMA's technical standards.

6. The initiative of the European Commission was well received by the co-legislators as, in light of the major scandals occurred with some widely used financial benchmarks, there was a general consensus that a stronger and more uniform regime in this area was needed. Nonetheless substantial changes reducing the initial ambition of the proposal were introduced during the negotiations carried out both in the Council and even more in the European Parliament. These changes were driven by three ranges of criticisms which in fact appeared as soon as the Commission's proposal was published.

First of all, a number of stakeholders voiced concerns about the potential unintended consequences of a regulation which was seen as too broad, due to the very wide range of indexes covered, too burdensome, with a number of provisions going beyond the IOSCO Principles, and potentially damaging the smooth functioning of the Benchmarks market.

Secondly, the 'one-size-fits-all' approach adopted by the Commission was strongly criticized by a number of market participants: a proportionate framework for non-critical benchmarks was sought, so as to take into account the different types and sectors of benchmarks falling under this category, notably in the commodity sector, where benchmark administrators argued against the application of financial benchmarks principles to non-financial indexes[31].

Last but not least, the third country issue was extensively debated. In particular, the fully fledged equivalence regime proposed by the Commission was re-

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[31]See notably concerns expressed by Price Reporting Agencies; eg. reply of Argus Media to the EU public consultation: "A wide range of indexes and benchmarks are used — the terminology used to refer to them is often imprecise and misleading — and Argus Media urges the Commission not to apply a "one size fits all" approach." http://ec.europa.eu/finance/consultations/2012/benchmarks/docs/contributions/registered-organisations/argus_en.pdf.

garded to be too strict and was deemed to represent a real risk of foreclosure for the EU marketplace, as no other jurisdictions outside Europe would have adopted equivalent legislative actions by the time the Regulation was due to enter into application.

Against this background, negotiations within the Council and the Parliament were characterized by intensive discussions, lasting almost two years (which is a rather long time for a relatively short text [32]).

Within the Council, three Presidencies had to deal with the file before securing an agreement on a common position among Member States (so called 'general approach'). Started under the Greek Presidency in the first half of 2014, the negotiations continued under the Italian Presidency during the second half of the year, and an agreement was finally reached under the Latvian Presidency in February 2015. During these extensive discussions substantial changes were introduced to the original Commission's proposal, so as to address the concerns raised by Member States and stakeholders. In order to calibrate the Regulation on different types and sectors of benchmarks for the sake of 'proportionality', the requirements applicable to the relevant administrators were better differentiated, while more proportionality for non-critical benchmarks was introduced, through a review of certain provisions (in particular the code of conduct requirements), aimed at making them more in line with the IOSCO Principles. The new category of 'national critical benchmarks'[33] was created and new criteria added for the definition of European benchmarks. Some categories of benchmarks were excluded from most of the requirements of the regulation. In particular, a specific regime for regulated-data benchmarks was envisaged to take into account the quality of

[32]The initial Commission's proposal was of 81 pages (including Annexes), which is rather short in comparison with other important proposals, such as MiFID (185 pages) or CRD IV (154 pages) in their initial version.

[33]Under article 20(1)(b) of the Benchmarks regulation, a benchmark can be deemed as critical when this "benchmark is based on submissions by contributors the majority of which are located in one Member State and is recognised as being critical in that Member State". In that case, however, neither the college nor the mandatory contribution (except for contributors based in the Member State) will apply.

input data and the limited discretion of administrators. As far as commodity benchmarks are concerned, these indexes were exempted from the title II of the Regulation, containing the most stringent requirements (such as the submitters code of conduct) and the regime was kept as close as possible to the inherent sectorial IOSCO Principles. Finally, in order not to prevent the use of benchmarks provided from administrators located in third countries until such time as an equivalent legal framework and supervisory practices would not be in place, the third-country regime was totally reshaped, by introducing more flexible measures. This was made through the insertion of a recognition regime, according to which benchmarks provided by a third country administrator might be used in the Union on condition of the existence of a cooperation arrangement between a EU competent authority and a corresponding third country competent authority for the administrator, and an endorsement mechanism, which instead relies more on the private initiative and thus on the possible agreement between an EU administrator and a third country administrator. A transitional regime and a review clause were also added to prevent any risk of 'cliff-effect' as of the entry into force of the new regulation.

In the European Parliament, the debate was even more controversial, and it took two legislatures – and two different negotiating teams - to find out a common position. The first round of discussions, started in 2013 under the previous legislature (2009-2014) led to a deadlock. The first rapporteur of the dossier (Ms Sharon Bowles, ALDE, UK), former Chairperson of the ECON Committee, clearly indicated from the early beginning of the negotiations that this proposed regulation had to be substantially amended. In her original draft report, published end of 2013[34], she notably proposed to reduce the scope of the regulation giving national authorities the power to include a benchmark administrator in it if necessary. She also suggested that third country equivalence assessments should have been

[34]See European Parliament (2013), *Draft report on the proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts* - (COM(2013)0641 – C7-0301/2013 – 2013/0314(COD)), 15 November.

based on compliance with IOSCO standards. In addition, the draft report included more wide-ranging powers for national authorities to mandate contributions to a critical benchmark. However, last-minute legal objections from the Social Democrat and Green political groupings[35] led Ms Bowles to postpone the vote on the draft report. The adoption of the Parliament's position was delayed until the new assembly was formed after the 2014 European elections for legislature 2014-2019. Under the impulsion of the new rapporteur, Ms Cora Van Nieuwenhuizen (ALDE, NL), the European Parliament finally found an agreement on a text in May 2015[36] which led to further substantial changes vis à vis the initial Commission's proposal. These changes are notably:

(i) an extension of the critical benchmarks' category, through the introduction of purely qualitative criteria[37], in addition to the quantitative thresholds set in the Commission's initial proposal;

(ii) for other benchmarks (non-critical benchmarks), the proportionality – already introduced in the Council text - was reinforced through the introduction of a list of exemptions from a number of provisions (that would no longer apply to all non-critical benchmarks);

(iii) and with respect to the third countries regime, recognition and endorsement would have been based, as an alternative, on the sole IOSCO principles.

In the end, the approach retained by the EP was the result of a complete

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[35] See European Parliament (2014), Meeting of Committee on Economic and Monetary Affairs 17 February (video available at http://www.europarl.europa.eu/ep-live/en/committees/video?event =20140217-1500-COMMITTEE-ECON).

[36] See European Parliament (2015), *Amendments adopted by the European Parliament on 19 May 2015 on the proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts* (COM(2013)0641 – C7-0301/2013 – 2013/0314(COD)) (available at http://www.europarl.europa.eu/ sides/getDoc.do?type=TA&lang uage=EN&reference=P8-TA-2015-0195#BKMD-9).

[37] See European Parliament (2015), *Plenary Sitting Report on the proposal for a regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts.*
(COM(2013)0641 – C7 0301/2013 – 2013/0314(COD)) 10.4.2015 Committee on Economic and Monetary Affairs; see article 13-2a.

different approach and philosophy in comparison to the Council's one. In the text of Council, the critical benchmarks' category was limited only to a small number of benchmarks (as in the original Commission's proposal), while the other types of benchmarks would have been subject to a full-fledged regime, with some exemptions for specific categories (commodities benchmarks, regulated-data benchmarks). The Parliament took the opposite view: the critical benchmarks' category was significantly enlarged through the introduction of qualitative criteria, but all the other benchmarks were subject to a 'light-touch' regulatory approach, with an exemption from almost all stringent provisions. As the rapporteur pointed out, the need was 'to focus on those benchmarks whose manipulation and/or cessation would do serious harm to financial and economic stability'[38] and to adopt a more proportionate approach for other benchmarks deemed as non-critical.

In this context, the main challenge of the discussions between the co-legislators carried out during the so called 'informal trilogues' was to reconcile the fundamental difference of approach between the Council's and Parliament's texts. Two main issues were particularly discussed during the Luxembourg's Presidency, who led most part of the trilogues in the second half of 2015[39]: (i) the proportionality – and in particular to which extent the approach retained by the Parliament was suitable for all non-critical benchmarks; (ii) the third-country regime, and in particular the issue of the substitution of IOSCO principles to a full-fledged equivalence to the EU legislation in the recognition regime.

To address the first issue, the co-legislators agreed on a new framework and on the introduction of three categories of benchmarks with the further distinction between significant and non-significant benchmarks within the non-critical category. To that end, a new threshold of 50 billion of Euro has been

[38] See RIMES (2015), EU Nations Poised to Agree on New Benchmark Regulations, 11 February.
[39] A political agreement was finally reached in December 2015.

introduced[40] to distinguish between significant and non-significant benchmarks, along with a discretion for national competent authorities to exempt the application of substantial parts of the regulation to the latter category. In addition to the exemptions applicable to certain categories of benchmarks (regulated-data, commodities) that were already envisaged in the Council's text, not only did this further distinction between significant and non-significant benchmarks reinforce the fragmentation of the regulatory framework in comparison to the initial 'one-size-fits-all' approach adopted by the Commission, it also substantially watered down the original ambition of the Commission's proposal.

With respect to the third-country issue, the approach finally retained by the co-legislators was also a compromise between the two positions. While recognizing the importance to stick to a real equivalence-based approach as in the Council's text, the final agreement introduced the possibility for national competent authorities to base their recognition assessment not only on the basis of the application of the regulation provisions by the benchmark administrators but also on the basis of IOSCO principles, 'provided that such application is equivalent to compliance with the requirements established in this Regulation'[41]. In other words, by allowing this reference to international standards as an alternative to the EU regulation - but under the strict condition that compliance to these principles would render their application as stringent as the full application of the regulation itself - the third-country regime as elaborated in the Council text was rather streamlined than substantially changed.

The Regulation was published in the EU Official Journal on 29 June 2016 and will be fully effective in the whole territory of the European Union as of January 1, 2018.

The distinctive feature of the negotiations that led to the approval of the

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[40]Among the criteria that were introduced to distinguish between significant and non-significant benchmarks, a threshold of 50 billion euro was inserted, above which a benchmarks is deemed to be significant and non-significant if below this threshold. See Regulation (EU) 2016/1011, article 24.

[41]See Regulation (EU) 2016/1011, article 32.

text by the European co-legislators was the effort to realign the restrictive approach chosen by the Commission to the more flexible provisions of the IOSCO principles, supported or not by participants.

7. In parallel with the international regulatory workstreams and even before the European Union adopted, first jurisdiction in the world, an overarching legislation for producing and using benchmarks, the United Kingdom had launched an autonomous reform of the sector.

A regulatory framework for financial benchmarks was introduced in that jurisdiction following the Wheatley Review of LIBOR dating back to 2012[42]. According to such framework, which became legally binding through amendments to the Financial Services and Markets Act 2000 (FSMA) and associated Regulated Activities Order, submitting to and administering some specified indices have become regulated activities. That means that contributors to and administrators of some specified benchmarks have to be authorized by the Financial Conduct Authority (FCA) and comply to a set of standards and recommendations whose violation brings about a wide range of sanctions. The relevant benchmarks are named by the Government through secondary legislation. Since it was recognized that benchmarks can greatly differ one another as for construction and operation, the legislative framework provides for some flexibility so as to suit the specific characteristics of each one. Furthermore, as also recommended by the Wheatley Review, the new offense of 'manipulation of relevant benchmarks' has been introduced, where the 'relevant benchmarks' are also identified by the Government through secondary legislation.

Initially only LIBOR was included in the scope of the new regulatory framework by the British Government, as a response to the findings raised in the wake of scandals, both from the contributors' side (where discretion in data submitting and lack of adequate controls had exposed the index to manipulation), and from

[42]See WHEATLEY (2012), *The Wheatley Review of LIBOR: final report*, September.

the administrator's (which, according the Review, had not exercised sufficient oversight). Right from the start, however, it was acknowledged that other indexes should have been brought within the scope of the new legislation. The scope was therefore broadened under the Fair and Effective Markets Review (FEMR), which is the comprehensive assessment of the functioning of wholesale markets started by the British Government in 2012 in order to help restoring investors' confidence and influence the international debate on trading practices. The FEMR Final Report was published in June 2015[43], but already in 2014 an interim report[44] recommended to include seven additional benchmarks[45] in the scope of the new UK legislation, six of which meet the 'critical benchmark' definition set out in the EU Regulation. They are namely indices used in fixed-income, currency and commodity (FICC) markets, including associated derivatives, whose disruption would cause huge risks to investors and to the economic and financial system as a whole. The interim report also provides recommendations on how the regulatory regime should be applied to each of these indices. After a public consultation, the UK Government accepted the FEMR recommendations turning them into effective legislation as of April 1, 2015.

The new legislation was to be replaced by the European Regulation (that was still in negotiation then), but the UK Government decided to adopt it in advance to provide a prompt response to the LIBOR scandals, to fill the legal vacuum until such time as the EU Regulation would not be fully effective and, above all, to influence the ongoing debate at European and international level.

The EU Regulation entered into force on June 29, 2016, just a few days after the referendum on Brexit, through which the majority of British citizens came out in favor of the UK leaving the European Union. No matter when and how

[43]See SHAFIK – ROXBURGH - WHEATLEY (2015), *Fair and Effective Markets Review - Final Report*, June.
[44]See SHAFIK – ROXBURGH – WHEATLEY (2014), *FEMR - Recommendations on additional financial benchmarks to be brought into UK regulatory scope - Report to HM Treasury*, August
[45]See They added bench marks are SONIA. RONIA, WM/Reuters (WMR) 4pm London Closing Spot Rate, ISDAFIX, London Gold Fixing, BMA Silver Price, ICE Brent.

Brexit will arise: it will have a considerable impact on financial services, a crucial sector for the UK economy. The terms of Brexit will certainly be the subject of lengthy and intensive negotiations in the coming months. Be that as it may, the currently available data suggest that Brexit will only minimally exempt the United Kingdom from the EU financial regulation, whose pervasiveness and complexity had provided much ammunition to supporters of ' leave'.

When negotiating the future relationship with the European Union, indeed, the UK is likely to be determined to maintain access to the EU market for its financial services industry. Therefore it will have to comply with a large part of the EU financial regulation applicable to date, in order to award a privileged status for authorization or equivalence decisions. Pending Brexit, the UK regulatory authorities have to work together with benchmark administrators to ensure compliance with the EU Regulation. It is reasonable to expect that such compliance is to be preserved even after the Brexit, in order to grant the equivalence of the national scheme to the European one and maintain a door open to EU markets for the UK benchmark industry.

8. The UK is likely not to be the only (possible) third country to calibrate its own benchmark legislation on the EU framework. In the wake of the review[46] carried out after the publication of its Principles, in fact, the IOSCO is considering to adopt the EU approach to provide guidance in setting out a lighter regime for less critical benchmarks. '*You've seen the example of proportionality in the EU regulation in terms of the approach they've taken [in classifying] critical, significant and non-significant benchmarks. ... Proportionality and how full compliance is interpreted in relation to the principles are two things we are thinking about,*' IOSCO

[46]See IOSCO (2015), *Review of the Implementation of IOSCO's Principles for Financial Benchmarks*, February; IOSCO (2015), *Review of the Implementation of IOSCO's Principles for Financial Benchmarks by Administrators of Euribor, Libor and Tibor*, February; IOSCO (2016), *Second Review of the Implementation of IOSCO's Principles for Financial Benchmarks by Administrators of EURIBOR, LIBOR and TIBOR*, February.

Chairman Greg Medcraft said[47]. The European Regulation seems therefore close to become 'the benchmark' for the international benchmark regulatory framework. That is an exceptional result which reverses, perhaps for the first time in a so explicit manner, the consolidated rule maker-rule taker relationship between global standard setters and single jurisdictions.

In the first instance, the European Commission, which is the Institution responsible for the legislative initiative within the EU, had had to scale down its ambition to create a full-fledged overarching benchmark regime, more stringent than the relevant international standards (IOSCO Principles). On the one hand, in fact, a large part of market participants, while calling for a regulatory response to restore the investors' confidence after the alleged manipulation of some indices, invited to recognize the wide variety of existing benchmarks and feared the risks of a one-size-fits-all approach for the survival of less critical indexes administered by small sized entities. On the other, as a corollary, the full-fledged equivalence regime for third countries was likely to interfere with the functioning of global markets. These issues were reflected in the push to a realignment with international standards emerged during the negotiations leading to the adoption of the proposed Regulation. Thanks to the work done by the European co-legislators, though, such realignment has not resulted into a mere transposition of the IOSCO Principles, but rather in an effective proportional implementation thereof, which, in association with an outcome-based third country regime, is likely to become a model for the evolution of the relevant international regulatory framework. Being a 'creative first mover' has paid off.

No single Member State could have achieved this result standing alone, not even having a leader industry such as the UK. The global dimension of financial markets and the subsequent peculiarities of its regulation make it more and more evident the need to counterbalance the preponderant role played by global

[47]See CONTIGUGLIA (2016), *Iosco considering benchmark proportionality guidance*, Risk.net 4 May

standard setters with their indications recipients' political scrutiny. In the absence of such a scrutiny one might see a lack of democracy in the process presiding over the adoption of financial legislation. Conversely, such scrutiny can have an impact on the international scene only if it is carried out by players who, by size and influence, play a primary role on the global arena. Europe should draw some general lesson from the restricted example of the Benchmarks Regulation. And the UK as well.

FINANCIAL STABILITY AND ECONOMIC GROWTH IN THE NEW EUROPEAN REGULATORY FRAMEWORK: AN ANALYSIS OF EUROPEAN LONG-TERM INVESTMENT FUNDS

Angela Troisi* – Julie McFarlane**

ABSTRACT: *The aftermath of the recent financial crisis has introduced several regulative challenges within the European Union (EU). One of these relates to the rules applicable to banking and financial markets, including the renewal of European banking supervisory and resolution systems, which in turn has meant a new approach to the relationship between the financial sector and the real economy.*

The aim of the paper is to provide the reader with a precise review of the most important regulatory reforms in the EU that could address the need for financing sources available to industrial markets. At the same time, the analysis takes into account the most problematic issues currently concerning the European banking system, and the significant ineffectiveness of the ECB's monetary policies.

Specific attention is paid to European long-term investment funds and the new regulations applicable to them. The analysis provides evaluations of future development opportunities among European mid-tier enterprises. The paper concludes by highlighting some general concerns that may influence market stability, as well as the need for speedier economic growth.

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*Research Fellow at LUISS Guido Carli University, Department of Business and Management, Rome

**Assistant Professor at Heriot Watt University, Department of Business Management, Edinburgh

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1. In the aftermath of the recent financial crisis the European authorities focused their attention on ensuring long-term financial stability and avoiding new global threats that could jeopardise regional integrity, financial stability, and economic growth. In this respect, a new regulative framework has been introduced, which aims to set up rules for a European supervisory system, a European resolution and recovery system, and common standards for depositors' funds. Moreover, a new Investment Plan for Europe has been adopted in order to provide deeper bases for sustainable growth and resources for European economic markets.

Over the past few years, some European States (namely Spain, Ireland and Greece) have experienced severe difficulties in their financial markets, their economic basics have become very fragile, and banking instability has caused general turmoil in these nations. That unstable framework was quickly transmitted across the entire European Union, prompting several questions about long-term European resilience and sustainability.

Those national collapses and consequent threats were the symptoms of deeper diseases that are still affecting economic and financial markets to this day. In fact, as the European Banking Authority has recently declared, the EU is actually characterized by an unprepared banking system that is suffering setbacks stemming from exposures to risky assets and poor management strategies[1]. Furthermore, fragility continues to affect financial markets, and is turning into volatility in banks' funding spreads and elevated conduct risks[2].

With regard to the banking system, European banks and national authorities have shown inadequate approaches to Banking Union and supranational banking regulation that in some European Member States have become deeply

[1]See EUROPEAN BANKING AUTHORITY, *Risk Assessment of the European banking system*, January 2016.
[2]See CCP RESEARCH FOUNDATION, *Conduct Cost Project Report 2015*, July 2016.

exacerbated by national political instability and social criticism[3]. The underlying reason for this is that over-reliance on banks is a widespread phenomenon among European countries; in fact, some economic scholars recently pointed out that the European economic system is more strongly focused on banks than the USA's system is. As a result, the 2008 financial crisis caused a deeper long-term impact on the European market than the USA's; hence, the former is experiencing a very low economic growth rate.[4]

Despite expectations, the overall effects of recent banking and financial reforms have been strictly limited, with the result that the current banking system actually resembles that of 2006, especially concerning the problematic aspects of institutions deemed "too big to fail" (e.g. in the case of Italian banks generally and Monte Paschi di Siena in particular), and their spillover effects for the rest of the financial system and for the real economy.[5]

The reminder of this paper is structured as follows. Section 2 analyses the European financial markets, some relevant problems affecting the banking and industrial system, and finally, some financial intermediaries that might boost economic growth and financing opportunities for European enterprises (especially SMEs). Section 3 undertakes a brief overview of alternative financing sources for SMEs, largely introduced by recent European regulations. Section 4 briefly analyses Long-term Investments Funds, before section 5 concludes the paper.

2. During the past few years, policies of European integration have implied new legislative initiatives concerning with regard to (i) European banking supervision, (ii) economic growth, and (iii) the minimization of systematic risks across countries. Firstly, it is worth noting that we benefit nowadays from supranational

[3]See CAPRIGLIONE – SACCO GINEVRI, *Politics and Finance in the European Union. The reason for a difficult encounter*, Torino, 2016, Chapter I.
[4]See LANGFIELD – PAGANO, *Bank Bias in Europe:Effects on Systemic Risk and Growth*, ECB Working Papers Series, no. 1797, May 2015.
[5]See JOHNSON, *The End of Big Banks*, February 29 2016, available on *Project Syndicate*; ID., *Failure at the Financial Stability Board*, November 30 2015, on *Project Syndicate*.

regulation of bankruptcy, in line with the introduction of cross-border services, international banking institutions, and globalization. In fact, bankruptcy seems to be one of the most important parts of banking regulation; also, former Italian banking regulation from 1936 provides a huge legislative framework concerned with banking crises as the banking business was (and still is) inherently risky and, above all, it involves savings from depositors and naïve investors.

A new approach to bankruptcy and financial stresses was adopted by the EU in order to implement new recovery and resolution rules for banking crises; thus, a more consistent framework for banking regulation became the optimal choice for solving a large set of problems relating to financial instability and a non-homogeneous playing field. And, in fact, the Bank Recovery and Resolution Directive (2014/59/EU) forms part of the EBU's second pillar as long as it represents one of the major goals of the ambitious Banking Union. Nevertheless, the BRRD results in a minimal harmonisation of bank resolution rules, perhaps because the European regulator has taken into account the effective need for a gradual reconstruction of the entire banking and resolution system in place of radical and unexpected reforms. However, innovative rules for financial markets and banking crises seem to be insufficient to boost growth and economic recovery across the EU. Additionally, a vicious circle involving sovereign debt and bank debt has been created, especially in some European countries such as Spain, Greece and Ireland whose governments had to bail banks out at enormous cost to the entire population.

What also seems relevant here is that institutional players such as the Basel Committee and the International Monetary Fund highlighted that national authorities should have the tools to activate an orderly resolution of all types of financial institutions, as the possession of these might contribute to the minimization of systemic risk, the protection of consumers, the limitation of moral hazard, and overall, the promotion of market efficiency.

Secondly, European economic growth is not sustained by the banking system. Banks do not adequately meet the financial expectations of the real economy and SMEs (small and medium-sized enterprises). This is because banks do not have adequate incentives to offer new forms of financial resources to businesses, despite the monetary policies pursued to date by the ECB and the political-institutional efforts made by institutional parties[6]. On the other hand, in fact, banking intermediaries are unable to carry out a re-composition of their assets, clear their portfolios from government bonds and use the available sums to provide credit to businesses and families; indeed, this operation could prove to be detrimental in terms of capital reserves (and possibly also in asset quality reviews), since the latter are very low (if not absent) when the bank holds government bonds, while they are more conspicuous when the bank holds private client loans.

The relationship between banking institutions and SMEs is of vital importance, especially for those enterprises lacking direct access to capital markets (and which are not mini-bond issuers); for instance, Italian companies can essentially only count on self-financing and on bank lending, thus suffering the effects of business cycles, as well as being vulnerable to fluctuations in interest rates. In addition, they mostly have access to short-term debt (instead of long/medium term loans), and are therefore largely discouraged from implementing new long-term business projects and from planning new production initiatives.

For this reason, financial disintermediation is becoming an increasingly common phenomenon across the EU and the USA, and is substantially encouraging the gradual transition to non-bank-centric markets specifically advocated by the European Commission in Capital Markets Union Action Plan on the 30th September 2015[7]. Not surprisingly, EU institutions underlined the role of direct lending and the multiple forms of peer-to-peer lending available in international markets: a good example is crowdfunding, which has become extremely popular and

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[6]See VAROUFAKIS, *The Politics of Negative Interest Rates*, available at *Project Syndicate*, August 22nd 2016.

[7]http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

effective among innovative start-ups and high tech business projects[8].

More generally, it is worth mentioning that according to the Italian legislative decree no. 91 of June 24, 2014, the so-called "Decreto Competitività", converted with amendments by Law no. 116 of 11 August 2014, in addition to banks and traditional financial intermediaries, the issue of borrowing financial resources is currently also allowed in relation to insurance companies[9] and securitization companies[10], as well as to SICAVs and SICAFs and some categories of investment funds[11].

Lastly, the current financial and banking market is affected by the monetary policies adopted by the ECB and their poor expected results[12]. In fact, two categories of problems are related to negative rates in the financial markets: the first is due to the complete disconnection between the financial market and the banking market, where the former is characterized by very low rates (which are basically intended to stimulate the circulation of money), while the banking system is still unable to give credit, except to large enterprises (which have no need for relief on credit, because they are stable enough to operate autonomously). In this respect, SMEs are still excluded from efficient banking channels, hence the investment funds might have a relevant role and cooperate with the banking system creating

[8]See MOLLICK, *The dynamics of crowdfunding: an explanatory study*, Journal of Business Venturing, vol. 29, no. 1, 2014; KUPPUSWAMY – BAYUS, *Crowdfunding Creative Ideas: the Dynamics of Project Backers in Kickstarter*, SSRN Electronic Journal, March 2013; CORDOVA – DOLCI – GIANFRATE, *The Determinants of Crowdfunding Success: Evidence from Technology Projects*, Procedia – Social and Behavioral Sciences, vol. 181, 2015.

[9]See IVASS document no. 22, October 2014, which modifies ISVAP REgulation no. 36 of January 31st 2011. In addition, see new consultation document available at www.ivass.it/ivass_cms/docs/F19655/Documento_per_la_consultazione_n_26_2015.pdf

[10]Decreto Competitività has modified the past law no. 130/1999 concerning with securitization, allowing to special purpose vehicles to borrow financial resources to large enterprises and SMEs.

[11]See PELLEGRINI – TROISI, *Gli operatori del mercato finanziario: regolazione e supervisione*, *Corso di diritto pubblico dell'economia*, ed. by Pellegrini, Padova, 2016

[12]See SZCZERBOWICZ, *The ECB unconventional monetary policies: have they lowered market borrowing costs for banks and governments?*, International Journal of Central Banking, vol. 11.4, 2015; BARIGOZZI – CONTI – LUCIANI, *Do euro area countries respond asymmetrically to the common monetary policy?*, Oxford bulletin of economics and statistics, vol. 76.5, 2014; ESER – SCHWAAB, *Evaluating the impact of unconventional monetary policy measures: Empirical evidence from the ECB′ s Securities Markets Programme*, Journal of Financial Economics, vol. 119.1, 2016.

a smooth support network to the entrepreneurial system. The second category of problems related to the negative rate policy relates to the unplanned effects of the ECB's monetary policy; more specifically, in the presence of low rates companies prefer to invest in technologies rather than in specialised human resources, thus increasing the unemployment rate over the longer term. In addition, investors opt for riskier investments in looking for higher returns, and increase the overall systemic instability; finally, older generations tend to spend less because they receive more meagre remuneration from their savings, thus decreasing the levels of general consumption[13].

3. As was previously mentioned, the current economic situation in Italy is characterized by the deadlock which has been established due to the combined effect of multiple factors, among which are the credit crunch (which damaged bank-business relationships), the scarcity of public instruments in support of the economy (mainly related to the compliance of the well-known Maastricht limitations), and the uncertainty which can be directly to the structure of the banking system. It is therefore necessary to look for valid tools that might help to untangle the current knots and increase the strength of Italian and European companies. More specifically, it is necessary to identify the operators who are able to finance national businesses and the strategic economic sectors. The intervention of these entities (mainly mutual funds and investment entities) would have particular positive effects not only on the performance of the economic system, but also on the stability of the financial market; the latter, in fact, could indirectly benefit from the economic recovery and support the gradual absorption of so-called non-performing loans (NPLs)[14].

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[13]See STIGLITZ, *What's Wrong with Negative Rates?*, available on *Project Syindicate*, April 13rd 2016.

[14]See MAKRI - TSAGKANOS – BELLAS, *Determinants of non-performing loans: The case of Eurozone*, Panoeconomicus, vol. 61.2, 2014; HALE – SANDERSON, *How do you solve a problem like Italy's non-performing loans?*, Financial Times, July 27th 2016.

With regard to this last issue, it is worth mentioning that the sale strategies of non-performing loans are particularly relevant for banking intermediaries and, in general, to the entire national economy. In fact, the sale of NPLs allows banks to activate so-called "leverage-effects"; thus decreasing balance sheet exposures (derived from the sale of these bad credits) and increasing the cash flow which can then be granted to families and businesses.

The introduction of mutual funds that can invest in loans originated by third parties or issue them directly is one of the major EU initiatives forming part of the restructuring plan for the morphology of the European financial system. Loan funds are a potentially valuable tool for European financial efficiency, as well as a credible solution to the funding gap faced by SMEs, which actually contribute 58% of added value and 67% of employment at the European level. In addition, investment funds could cooperate with banks in financing particularly expensive projects, covering credit needs and different risk levels (in line with the strategic criteria of the fund itself).

In general, the activity of loan funds requires adequate analysis to verify that the implemented strategies are conducted in accordance with cost-efficiency criteria; this is in order to avoid the creation of adverse selection phenomena and an overall deterioration in the quality of financial instruments available in the market. In this regard, it must be ensured that the securitization of NPLs reflect the real credit rating associated with these instruments, and at the same time that the assessments made available by rating agencies are reliable and transparent. This is to ensure that the information provided to the public is conveyed in a clear and direct way, and is therefore able to facilitate an *ex-ante* selection of the type of investors (retail and professional) to which the potential placement of complex financial products is intended.

The availability of investment funds able to finance the economy and support economic growth is not limited to loan funds, and includes certain other types of funds, all kept together by the high level of specialization and the strong inclination towards productive investments. Some of these are therefore included among the EUVECA funds (European venture capital funds, regulated by Regulation (EU) No. 345/2013), the EUSEF funds (European Social Entrepreneurship Funds, regulated by Regulation (EU) No. 346/2013) and the ELTIF funds (European Long-term investment funds) that encourage the raising of the necessary financial resources for specific business projects[15].

More specifically, the European legislator has decided to strengthen the access to finance of SMEs by creating an "identity passport" (EU-wide passport) for EUVECA funds, and for the EUSEF funds managed by fund managers which are subject to the AIFM directive (Alternative Investment Fund managers, directive 2011/61/EU). On the one hand this delimits the range of action of EU funds (which are specifically targeted towards sole innovative projects), but on the other hand it ensures the creation of a level playing field throughout EU member States.

4. The European Long term investment fund (ELTIF) is a Pan-European regime for alternative investment funds which raises capital and makes it available for loeng term investments in the real economy, in line with the European Union objective of smart, sustainable and inclusive growth, as mentioned by the European Commission in its Work Programme for 2016[16]. In this respect, specific attention is paid to efforts by the European regulator to introduce a “New Skills Agenda” for Europe involving measures for adopting a circular economy package, and long-term financing for European enterprises[17].

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[15]See ASSOGESTIONI, *Response to the EU Commission’s Consultation Document – Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations*, 5th January 2016, where it is highlighted the main role of these funds. In fact, «diversification of sources of financing, by levereging on, amongst others, already existing EU invesment products, such as EuVECAs, EuSEFs and ELTIFs, can have the potential, if appropriately calibrated, to attract investments of both professional and retail investors, and reach eligible investment targets that are crucial for the growth of the EU economy, such as SME fundings and infrastructure projects».

[16]See European Commission Work Programme 2016 and the new agenda about growth, youth and the real economy.

[17]See Green Paper Long-Term Financing Of The European Economy, March 2013, available at http://eur-lex.europa.eu/resource.html?uri=cellar:9df9914f-6c89-48da-9c53-

With regard to new financing opportunities for SMEs and the real economy, the European regulator introduced a specific ELTIF Regulation (no. 2015/760 of the European Parliament and of the Council) that lays down the minimum requirements which must be met by long-term funds in order to be authorized as a European long-term investment fund. However, in line with the rules provided for EUVECA and EUSEF, ELTIF must be managed by authorized Alternative Investment Fund Managers (regulated by the aforementioned AIFM Directive), and must meet minimum eligible asset and diversification requirements.

ELTIFs may invest (for minimum 70% of its capital) in long term assets such as small and medium sized businesses, social infrastructure, transport, sustainable energy and communications infrastructure. Moreover, they can raise capital from institutional and retail investors across Member States and other European Economic Area (EEA). And in fact, pursuant to Regulation Whereas no. 41, given the specific characteristics of retail and professional investors, «it is important that sound transparency requirements be put in place that are capable of allowing prospective investors to make an informed judgement and be fully aware of the risks involved»; furthermore, European regulator addresses some specific requirements in terms of cross-border marketing policies, hence naïve investors could be coherently informed about risks, redemption rights, future financial returns, and, above all, investment strategies performed by ELTIFs.

More specifically, the allocation of ELTIF shares requires a deep knowledge about the nature of retail investors and their past experience in the investment field relevant to the fund; in this respect, ELTIF managers have to clarify retail investors' financial situations (including their ability to bear relevant losses), and their investment objectives, in terms of time horizon and financial expectations.

It is worth noting that retail investors suited for ELTIF are characterized by

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d9d6be7099fb.0009.03/DOC_1&format=PDF, where the European regulator underlines that «the capacity of the economy to make such long-term financing available depends on the ability of the financial system to channel the savings of governments, corporations and households effectively and efficiently to the right users and uses through open and competitive markets».

such inclination towards long term exposures and illiquid assets to hold in their portfolios. 1At the same time, ELTIF could rise money from professional investors, which are investor which is considered to be a professional client, or may, on request, be treated as a professional client in accordance with Annex II to Directive 2014/65/EU (art. 2). This category typically includes small and medium sized investors who look for long term investment opportunities and sustainable financial returns in line with a moderate risk level. As was previously mentioned, also in this case an ELTIF manager could make investments across European countries, on a cross-border basis and in line with the legislative framework provided by AIFM Directive. However, specific attention is paid to applicable investment rules and permitted activities, including portfolio diversification rules and a list of prohibited activities. In fact, in order to ensure the integrity of ELTIF, it is recommended to prohibit an ELTIF from adopting certain investment strategies that involve risky transactions and illiquidity financial products. Specific rules are required for investing in derivatives (that are substantially permitted just for hedging purposes) and over-the-counter contracts (such as OTC derivatives) that must be subject to Regulation (EU) no. 648/2012[18] of the European Parliament and of the Council[19]. In fact, as deeply analysed by economical and doctrinal studies, financial derivatives are «cloistered and complex» products, which captured the world's attention as they were born in the flowing stream of globalization; and the development of the international financial markets allowed their gradual diffusion among professional operators and intermediaries[20]. As a consequence of historical absence of

[18]See TROISI – ENGST, *ESMA supervision. Specificity of the intervention in the derivatives market*, Law and Economics Yearly Review, 2013.

[19]See MOLONEY, *EU Securities and Financial Markets* Regulation, third edition, Oxford University Press, 2014. p. 479, where the Author identifies the main issues concerning OTC markets, supervision, and transparency; see also LUETTRINGHAUS, *Regulating Over-The-Counter Derivatives In The European Union -- Transatlantic (Dis)Harmony After Emir And Dodd-Frank: The Impact On (Re)Insurance Companies And Occupational Pension Funds*, Columbia Journal of European Law, 2012. For an extensive of the legal and regulatory principles underlying OTC markets and financial derivatives, see HUDSON, *The law on financial* derivatives, 5th edition, London, Sweet & Maxwell, 2012.

[20]See LIPUMA – LEE, *Financial Derivatives and the Globalization of Risk*, Duke University Press, London, 2004; MACKENZIE – MILLO, *Negotiating a market, performing theory: The*

transparency and structural principles ruling counterparties and contractual aspects, OTC derivatives are characterised by an enormous volatility that induces investors to lead with short term fluctuations, and uncontrolled oscillations in exchange and interest rates[21]. It is clear that such a situation is not suitable for ELTIFs and, above all, there is no adherence between the former and the financial objectives of the latter, also given the long-term strategic orientation that distinguishes ELTIFs from other forms of investment funds.

With regard to the investors and their need of protection, Regulation 2015/760 provides also rules concerning with fund's lifetime, redemptions and shares' distribution on secondary markets. In fact, pursuant to art. 18, a specific linkage between life of an ELTIF and the shares' (or units') redemption, thus investors in an ELTIF are forced to wait the day following the date of the end of ELTIF's life in order to request the redemption of their shares or units. Derogations from this main rule are allowed if specific conditions are fulfilled, such as in case of a clear, fairly and time-constrained redemption policy that is initially defined by managers and disclosed to investors[22]. The reason for this is certainly due to the need for maintaining a stable fund platform up to the ELTIF's lifetime in order to

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historical sociology of a financial derivatives exchange, 2001, available at ssrn.com; WALDMAN, *OTC Derivatives and Systemic: Innovative Finance or the Dance into the Abyss?*, Am. UL. Review, vol. 43, 1993.

[21]See BARTRAM - BROWN – FEHLE, *International evidence on financial derivatives usage*, Financial management, vol. 38.1, 2009; BINGHAM – KIESEL, *Risk-neutral valuation: Pricing and hedging of financial derivatives*, Springer Science & Business Media, 2013.

[22]Pursuant to art. 18.2, the conditions under which derogation are allowed are: «(a) redemptions are not granted before the date specified in point (a) of Article 17(1); (b) at the time of authorisation and throughout the life of the ELTIF, the manager of the ELTIF is able to demonstrate to the competent authorities that an appropriate liquidity management system and effective procedures for monitoring the liquidity risk of the ELTIF are in place, which are compatible with the long-term investment strategy of the ELTIF and the proposed redemption policy; (c) the manager of the ELTIF sets out a defined redemption policy, which clearly indicates the periods of time during which investors may request redemptions; (d) the redemption policy of the ELTIF ensures that the overall amount of redemptions within any given period is limited to a percentage of those assets of the ELTIF which are referred to in point (b) of Article 9(1). This percentage shall be aligned to the liquidity management and investment strategy disclosed by the manager of the ELTIF; (e) the redemption policy of the ELTIF ensures that investors are treated fairly and redemptions are granted on a pro rata basis if the total amount of requests for redemptions within any given period of time exceed the percentage referred to in point (d) of this paragraph».

engage investments as safer as possible; this in turn means that ELTIF's lifetime has to be necessary coherent with the life-cycle of each asset included in its investment portfolio, hence ensuring that assets are chosen in the light of their time-frame and financial returns.

And in fact, pursuant to art. 13, an ELTIF's investment portfolio can be divided as follows: 10% of its capital in instruments issued by any single portfolio undertaking; 10% of its capital directly in a single real asset; 10% of its capital in units of a single ELTIF, EuVeca or EuSEF[23]; 5% of its capital in eligible assets for UCITS, where those assets have been issued by any single body. These diversification requirements seem to be the optimal way to satisfy the interest of the investors, and, at the same time, it permits to concentrate the ELTIF's investment policy towards industrial projects, SMEs businesses, and undertakings from real economy[24].

Furthermore, an ELTIF can also operate as loan originator. In this respect, some requirements are provided by art. 16: the borrowing of cash is, in fact, permitted by the European regulator only if it represents no more than 30% of the value of the capital of the ELTIF; it serves the purpose of investing in eligible investment assets (except for loans to qualifying portfolio undertakings) provided that the holdings in cash or cash equivalents of the ELTIF are not sufficient to make the investment concerned; it is contracted in the same currency as the assets to be acquired with the borrower cash; it has a maturity no longer than the life of the ELTIF; and finally it encumbers assets that represent no more than 30% of the value of the capital of the ELTIF.

In this way, ELTIFs could concentrate their investment strategies towards

[23]In this respect, it is worth noting that The aggregate value of units of ELTIFs, EuvECAs and EuSEFs in an ELTIF portfolio must not exceed 20% of the value of the capital of the ELTIF. An ELTIF cannot acquire more than 25% of the units or shares of a single ELTIF, EuVECA, or EuSEF.

[24]In fact, an ELTIF is prohibited from short selling of assets, taking direct or indirect exposure to commodities, and entering into securities lending, securities borrowing, repurchase transactions, or any other agreement which has an equivalent economic effect and poses similar risks, if thereby more than 10% of the assets of the ELTIF are affected.

economically and socially valuable investments, hence contributing to the European economic growth and obtaining political and institutional supports from Capital Markets Union and other European institutional initiatives[25].

Finally, European regulator pays specific attention to transparency and to provide punctual requirements for the financial prospectus issued for retail investors in order to prevent them from bearing unjustified losses and unreasonable fund misallocations. Pursuant to artt. 23 and 24, units or shares of an ELTIF must be marketed in concomitance of the disclosure of key information about their risks, returns, investors' rights, and lifecycle. These pieces of information have to be kept up to date, hence in case of relevant changes investors would be able to evaluate the level of risks and any potential future disadvantage on the elected investments.

As a matter of fact, the prospectus has been playing a key role in financial market since its gradual introduction. And in fact, it provides the investors with a mandatory disclosure of the issuer's characteristics and its instruments allocated on markets, thus improving also standards of corporate governance and the effectiveness of the implemented financial strategies. Moreover, the prospectus contributes to make available more information on markets, hence ensuring that more knowledge is available and «the closer to fairness the prices of securities are»[26].

In order to make investors conscious of all potential risks related to an ELTIF, the prospectus shall include specific warnings about some relevant aspects of the nature of the ELTIF. In this respect, the European regulator highlights the key importance of sharing information about the illiquid nature of the ELTIF, the long term nature of the performed investments, the redemption rights, the characteristics of investors which the ELTIF is marketed. This latter information is per-

[25]See EUROPEAN COMMISSION, *Green Paper - Building a Capital Markets Union*, COM(2015) 63 final, 18th February 2015, p. 3.
[26]See HAENTJENS - DE GIOIA CARABELLESE, *European Banking and Financial Law*, Routledge, 2015, pp. 30 - 31.

fectly in line with the principles of "know your customer" and "know the security", introduced by MiFID directive (2004/39/EC), which should ensure the maximum investor protection on financial markets[27].

In a nutshell, ELTIFs might provide a solution for current European financial and economic issues. In fact, they could create a mutually beneficial cooperation between the real economy and the financial markets, thus allowing European investors to participate in the re-building of the regional economy. Moreover, ELTIFs aim at representing an innovative form of European investment funds that will focus on assets designed to foster social and economic benefit. In fact, the underlying essence of ELTIFs is to facilitate the funding opportunities for SMEs and, at the same time, to create a level playing field between operators and undertakings from all European countries. Finally, this framework will be able to avoid any regulatory arbitrage among funds, enterprises and investors in EU, thus the EU integration could be encouraged and supported by innovative and homogeneous financial opportunities.

5. This paper sheds light on the aftermath of the recent EU financial crisis which has impacted upon both the banking sector and the financial market in Italy. It addresses the most problematic issues arising from the ineffectiveness of the ECB's monetary policies and the pressing need to identify private funding bodies who are willing to help to finance national businesses, and to support strategic economic growth. In reality, access to funding from mutual funds and investment entities can be difficult to obtain when a venture has limited legitimacy, or has suffered a fall in reputation or status, thus ultimately affecting the types of funders willing to invest[28]. Often, companies will use bootstrapping and bricolage techniques to ensure their ability to respond to changes in the environment and,

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[27]See CAPRIGLIONE, *Intermediari finanziari, investitori, mercati*, Padova, 2008, Chapter 3; DE MANUEL ARAMENDIA – VALIANTE, *A Life-cycle Approach to Investor Protection*, ECMI Working Paper, No. 1, September 2014.
[28]See BAKER – NELSON, *Creating Something from Nothing: Resource Construction through Entrepreneurial Bricolage*, Administrative Science Quarterly**,** 2005, vol. 50 no. 3, p. 329.

therefore, to contribute to growth [29]. Yet as Baum and Oliver suggest, an organisation's chances of success are significantly improved when it is able to develop ties with more established organisations[30]. Therefore, while these EU reforms may make access to funding a little more difficult for many, as Singh, House and Tucker observed, there is more than one way to create legitimacy and to access resources[31].

[29]See JONES - MACPHERSON - JAYAWARNA, *Learning to grow: dynamic capabilities in new technology-based firms.* OLKC 2011, Conference for Organisational Learning, Knowledge and Capabilities, "Making Waves", University of Hull, 12th -14th April, 2011, p. 13.

[30]See BAUM – OLIVER, *Institutional Linkages and Organizational Mortality*, Administrative Science Quarterly, vol. 36, no. 2, 1991, pp. 187-218.

[31]See SINGH – HOUSE – TUCKER, *Organizational Change and Organizational Mortality*, Administrative Science Quarterly, vol. 31, no. 4, 1986, pp. 587-61.

RETHINKING FINANCIAL REGULATION: AN APPRAISAL OF REGULATORY APPROACHES IN THE UK AND EU

Deepa G Driver**- Andrea Miglionico***

ABSTRACT: *This article explores different regulatory approaches that have shaped regulation in the run-up to and aftermath of the 2007-09 global financial crisis. In doing so it seeks to clarify and cast fresh light upon the shifting regulatory and practitioner discourse. This in turn is intended to aid reflection on how these approaches might best be adopted, adapted or synchronised to achieve the aims of financial regulation. The first part of this article examines the approaches from a theoretical perspective, discussing their strengths and weaknesses. The second part of the article analyses regulation in practice, focussing primarily on rules-based regulation and principles-based regulation. As a practical example, the article looks at the MiFID directive – a cornerstone of securities regulation – within the EU and UK jurisdictional context. The article concludes with observations and comments on how these approaches might best be coordinated to achieve the broader regulatory agenda.*

1. Financial markets provide the venue (real or virtual) and mechanisms for societal coordination by allowing buyers, sellers and intermediaries to value, transform and transfer resources. Their purpose – in the main – is to help bridge societal preferences in relation to maturity, liquidity, size and risk. Viewed holistically, and in the context of the satisfaction of societal needs, it is envisaged that

well-functioning financial markets can be used where appropriate to allocate resources and risk in a transparent and competitive[1] manner, facilitating economic development and progress within socially agreed boundaries[2] to both the applicability of marketisation[3] and its limitations.[4]

Faith in the sustainability and integrity of financial markets is of importance in societies that wish to largely rely upon market-based allocation of financial resources and risks in the long run. Such trust, in turn cements the role of markets as the primary choice of social institution used for resource allocation. Financial regulation serves as a community safeguard to proactively ensure safety, soundness and appropriate behaviour in financial markets. Given the inherent fragility entailed by the transformative activities undertaken in financial markets, it would be naïve not to recognise that institutional collapse or misbehaviour by financial intermediaries can have far-reaching societal consequences that are not easily remedied. As Beltran observes "the costs of preventive actions are usually tangible, clearly allocated and often short term, whereas the costs of failing to act are less tangible, less clearly distributed and usually longer term".[5]

The importance of financial regulation must not therefore be underesti-

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**Lecturer in Governance, Regulation and Risk at the ICMA Centre, Henley Business School, University of Reading.
***Teaching Associate in Banking and Finance Law at the Centre for Commercial Law Studies, Queen Mary University of London.
This article is a result of joint collaboration. Sections 1, 2 and 3 have been written by D.G Driver. Sections 4, 5 and 6 have been written by A. Miglionico. Section 7 presents shared reflections on the subject matter.
[1]Competition may not be considered the most appropriate remedy for natural monopolies for example. In such circumstances, it would not be appropriate to pursue higher levels of competition just as an end in itself.
[2]See CAMPBELL - PICCIOTTO, *Exploring the interaction between law and economics: the limits of formalism*, (1998) 18(3) *Legal Studies*, 249-250.
[3]A market-based solution may not be the optimal way to allocate resources in certain circumstances. For example, we may find that a market in child labourers or human body parts may not necessarily desirable.
[4]Implicit here is the view that not everything can and/or should be valued through markets. See SANDEL, *What Money Can't Buy: The Moral Limits of Markets*, Allen Lane, United King- dom, 2012.
[5]See BELTRAN, *Late lessons from early warnings: the precautionary principle 1896–2000*, Environmental Report No 22, European Environmental Agency, Copenhagen, 2001 at http://www.eea.europa.eu/publications/environmental_issue_report_2001_22.

mated. It is also important to recognize at the outset that financial regulation, in its role protecting the interests of societal stakeholders at large, is therefore imbued with both a socio-political purpose (such as protecting the interests of future generations or distributive justice) and an economic imperative (typically discussed within the welfare economics approaches to market failure).[6]

In the above context, this article sets out the thinking behind seven key regulatory approaches that have impacted financial regulation (particularly in the EU and the UK) in the run-up to and aftermath of the global financial crisis of 2007 (the GFC). These approaches are: rules-based regulation, principles-based regulation, outcomes-oriented regulation, risk-based regulation, judgement-based regulation, disclosure-based regulation and merit-based regulation. Our aim is to clarify and cast fresh light upon the weaknesses in the regulatory and practitioner discourse[7] and to corral a range of ideas so as to add depth to the discussion and allow for more critical reflection on whether these approaches might best be adopted or synchronised to better achieve the purpose of regulation.

In reviewing these materials, our analysis takes into consideration the evidence-based study presented by Di Lorenzo who rightly points out that “the public policy debate regarding the preference for principles-based or rules-based regulatory structures to achieve legislative congruence ignores the important role, often determinative role, of government enforcement measures”[8]. We are cognisant of an inherent bias when the predominant assumption within the supporting literature is of requiring regulatory efficiency and effectiveness and the acceptability of a non-zero failure regime rather than a more comprehensive safety culture.[9] There is also an assumption that greater efficiency equates to lower costs and bureauc-

[6]See DRIVER, *Governance, Financial, Regulation, Risk and Compliance: An Integrated Approach* (John Wiley and Sons, forthcoming).

[7]See ENGELEN, ERTURK, FROUD, JOHAL, LEAVER, MORAN, NILSSON, WILLIAMS, *After the Great Complacence: Financial Crisis and the Politics of Reform* (Oxford University Press, 2011).

[8]See DI LORENZO, *Principles-based regulation and legislative congruence*, (2012) 15(1) *New York University Journal of Legislation and Public Policy*.

[9]See PAUL - HUBER, *Risk-based Regulation in Continental Europe?*, HowSAFE Work- ing Paper No 2, February, 2015.

racy for the regulated community while a broader view of efficiency in terms of medium to long term social outcomes is typically underplayed in such discussions.

2. Rules-based regulation is a cornerstone of financial regulation in many jurisdictions including the US[10] and the UK. Detailed rules are viewed as providing a prescriptive, specific, concrete, procedural, and particular way of articulating regulatory requirements[11]. Generally, rules-based regulation is based on the provision and communication of such detailed requirements, and is intended to clarify regulatory expectations and set behavioural boundaries ex-ante. It is therefore purported to increase certainty for regulated entities, regulators and stakeholders. Specificity obviates the need for specialist interpretation of requirements. This, in turn, serves to reduce the cost and improve the ease of compliance for regulated entities (in particular for small firms that may have limited specialist compliance resource). However, on account of this same ex-ante nature, regulation composed of detailed rules may be over-inclusive or under-inclusive[12].

If rules are specific (as intended), then, in rapidly evolving markets such as finance, regulation may require frequent revision to keep up with the pace of change. This requires the expense of scarce time and resource, causing regulators to constantly fall behind market practice. By their very nature, rules may also be intransigent, providing both regulated entities and regulators with lesser choice in interpretation and in turn result in poor outcomes for both, in circumstances that where greater flexibility is deemed to be valuable. A more command and control, structure is often required for the promulgation of rules[13], denuding participatory ownership within the regulated community, notwithstanding any lobbying or

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[10]See BLACK, *Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis*, (2012) 75(6) *The Modern Law Review*, 1037-1038.
[11]See BURGEMEESTRE,HULSTIJN,TAN, *Rules-based versus Principle-based regulatory compliance*, Conference Paper presented at JURIX 2009: The Twenty-Second Annual Conference on Legal Knowledge and Information Systems, 2009.
[12]See BLACK, HOPPER, BAND, *Making a Success of Principles-based Regulation*, (2007) *Law and Financial Markets Review*, 191-192.
[13]See BLACK, *Rules and Regulators* (Clarendon Press, Oxford, 1997).

regulatory capture that might accompany such regulation and influence or subvert rule-making in the first place. For many regulated entities, this command-and-control approach to enforcing compliance with detailed rules may also engender a tick-box mindset aimed at meeting the 'letter of the law'[14]. As Frantz and Instefjord point out "the regulator must forward engineer the implications of compliance for the intended regulatory outcomes"[15]. Not only does this place an onus upon the regulator to prescribe the acceptable 'hows', it attracts criticism for resultantly excluding the possibility of alternative, potentially more effective processes undermining even those regulatees who might be able to devise more effective methods for meeting regulatory objectives. Worse still, rules-based regulation could be more easily subject to gaming through 'creative compliance'[16] and the misuse of legal and financial engineering[17] that are aimed at undermining or circumventing rules, complying with the letter of regulation while ignoring its spirit.

Principles, may be understood to be more 'generalised rules' or 'bright-line rules'.[18] They offer a higher-level, normative, broad-brush and more abstract specification of regulatory requirements.[19] Principles should therefore typically offer greater room to accommodate and interpret regulation taking into account the nuances of specific circumstances, thus facilitating the use of discretion when one size does not necessarily fit all. Both regulated entities and regulators may also more effectively apply reasoning to arriving at the right outcome.

The locus of ownership in complying with requirements is moved to the

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[14]See BLACK, HOPPER, BAND (note 12).
[15]See FRANTZ - INSTEFJORD, *Rules vs Principles-based financial regulation*, Working paper, 2014 at http://ssrn.com/abstract=2561370.
[16]See MCBARNET, *When compliance is not the solution but the problem: Changes in law to changes in attitude*, Australian National University, Centre for Tax System Integrity, Working Paper No 18, August 2001 at http://citeseerx.ist.psu.edu/viewdoc/download;jsessionid=5429976649F494B435383854C37BF93D?doi=10.1.1.20.8934&rep=rep1&type=pdf
[17]See MCBARNETT, *Financial Engineering or Legal Engineering? Legal Work, Legal Integrity and the Banking Crisis*, in I. MacNeil and J. O'Brien (eds), *The Future of Financial Regulation* (Hart, Portland, 2010).
[18]See FORD, *Principles-based securities regulation in the wake of the global financial crisis*, (2010) 55 *McGill Law Journal*, 257-258.
[19]See BURGEMEESTRE, HULSTIJN, TAN (note 11).

regulated entity through the opportunity to exercise greater judgement, thus purportedly allowing greater autonomy to market participants in outlining both business strategy and acceptable modes of compliance with regulation. There is however a trade-off with certainty, particularly when judging compliance or enforcing against non-compliance ex-post, given that the regulator's judgement may differ from those of the regulated entity. They may engender greater uncertainty through the variety inherent in the interpretation of principles, and therefore principles may be more difficult to enforce.

Principles may also be seen to facilitate ex-post re-examinations which may hold regulated entities up to differing standards than originally expected, due to the potential for a change in the thresholds against which interpretation of requirements might be carried out. Schwarz suggests that "unless protected by a regime enabling one in good faith to exercise judgment without fear of liability, such a person will effectively act as if subject to a rule and, even worse, an unintended rule"[20]. A corollary to this is offered by Sants who noted that "a principles-based approach does not work with individuals who have no principles"[21]. It is also worth bearing in mind that principles may require greater interpretation for appropriate application to circumstances, resulting in increased need for compliance expertise and associated costs. Like rules, subject to the quality of regulation, principles could also be gamed by those who chose to circumvent regulation – again the key to this lies in how the principles are applied and how enforcement action is taken for non-compliance.

There are some topics that lend themselves to detailed rules and others where a principle may set out the regulatory requirement more clearly. For example, when regulators set requirements for the disclosure documents on mortgage offers, they might require by rule the disclosure of certain pieces of information that consumers might legitimately require in order to make rational comparisons.

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[20]See SCHWARCZ, *The "Principles" Paradox',* Duke Law School Legal Studies Paper No 205, 2008.

[21]See *The Turner Review. A regulatory response to the global banking crisis*, March 2009, 86-87.

In such situations, a specific rule might be appropriate. In other circumstances, a principle such as requiring firms to ensure that all information provided to consumers is not misleading might better suit the desired outcome. Perhaps, as a result of this realisation, in practice, principles-based regulation – although deemed to be more sophisticated – has not meant that principles alone are used to communicate regulation or that they alone exist in practice to the exclusion of rules or a rulebook. For example, financial conduct regulation in the UK is deemed to be conducted in a principles-based manner, but a detailed rulebook also does co-exist supplementing high-level principles with detailed rules. This appears to be the case more generally at other Anglo-Saxon regulators who adopt principles-based regimes. Ford reminds us that the difference between rules-based regimes and principles-based regulation is not merely in opting for one drafting format rather than the other[22]. Importantly what varies between principles-based and rules based regimes is how regulators are expected to implement regulation – from the drafting of policy rules through to supervision and enforcement.

3. Although the five other approaches to regulation detailed within this article carry their own headlines and have independent standing in regulatory practitioner literature, in practice, regulation using these approaches when articulated typically takes the drafted form of detailed rules or high level principles[23].

Risk-based regulation is the most widely used and accepted amongst these, and is recommended for adoption by international bodies including the OECD and the British government across a range of industries from finance to healthcare. It

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[22]See FORD, *Principles-based Securities Regulation: A Research Study prepared for the Expert Panel on Securities Regulation*, at http://www.expertpanel.ca/documents/research-studies/Principles%20Based%20Securities%20Regulation%20-%20Ford.English.pdf. The author pertinently notes that “whether a regulatory system fosters clarity and predictability, for example, is not entirely related to whether it is rules-based or principles-based. The real question is whether regulator and regulatees have a shared understanding of what the regulations entail poor implementation can produce a system that is less transparent, less predictable, and less fair.”

[23]Other formats such as standards or codes of practice may also be used but in the jurisdictions related to this article, rules and principles form the predominant bulk of formal communication by regulators.

relates to the prioritisation of regulatory resources in both the functioning of the regulator as an institution and in the application of regulatory requirements (whether rules or principles) to regulated entities.

The OECD defines risk-based regulation as follows: "a risk-based approach to regulation explicitly acknowledges that the government cannot regulate to remove all risks and that regulatory action, when taken, should be proportionate, targeted and based on an assessment of the nature and the magnitude of the risks and of the likelihood that regulation will be successful in achieving its aims"[24]. Accordingly, regulators are required to allocate their resources to problems which are deemed to carry the highest risks as are regulated entities. It has been noted that "rather than trying to prevent all possible harms, risk-based approaches promise to rationalise and manage the inevitable limits of what regulation can hope to achieve by focusing regulatory standard-setting and enforcement activity on the highest priority risks, as determined through formal assessments of their probability and consequences"[25].

In parallel, regulated entities are expected to prioritise those risks which are deemed to be greatest. This approach to regulation came into prominence in the UK in the 1980s and 90s with the emergence of what Hutter refers to as the 'de-regulatory rhetoric'[26] with its emphasis on regulatory accountability, and economy in regulatory resource usage and associated regulatory costs, reduction of the regulatory burden on firms and the cost of compliance, as well as a philosophical bias towards adopting more private sector practices and styles in regulation.

In Anglo-Saxon jurisdictions, such rationality has been predicated on some form of formal risk assessment coupled with attendant prioritisation, which is typi-

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[24]See OECD, Risk and Regulatory Policy: Improving the Governance of Risk, OECD Publishing, Paris, 2010 at http://www.keepeek.com/Digital-Asset-Management/ oecd/gover nance/risk-and-regulatory policy_9789264082939-en#page1.

[25]See BEAUSSIER - DEMERITT, ET AL, *Accounting for failure: risk-based regulation and the problems of ensuring healthcare quality in the NHS*, (2016) 18(3-4) *Health, Risk and Society*, 2016.

[26]See HUTTER, *The attraction of risk-based ideas in regulation: accounting for the emergence of risk ideas in regulation*, London School of Economics Centre for Analysis of Risk and Regulation, Discussion paper No 33, March 2005 at https://www.lse.ac.uk/accounting/CARR/pdf/DPs/Disspa per33.pdf.

cally focused on regulatory efficiency. It has been argued that “risk has become a central means for making regulation socially optimal by using formal risk assessments of probability and consequence both to define regulatory objectives as well as target only the greatest threats to achieving those objectives”[27].

There are three key weaknesses of this regulatory approach. The first is that these risk-based regimes can be underpinned by a very simplistic evaluation of “risk to what”[28]. Efficiency increases through risk evaluations can tend to be simplistically equated to a reduction in regulatory costs or the reduction in costs or bureaucracy for regulated entities rather than a broader regard for systemic safety and consumer protection or the pursuance of stakeholder interests in the medium to long term. There is also the concern that the “risk-to-what” question can elicit very different answers based on the motivations and incentives[29] of regulators and regulatees creating greater fuzziness in the interpretation of regulatory principles.

Secondly, risk-based prioritisation requires the agreement of stakeholders in the acceptable negative outcomes. It is worth reflecting on the underlying point made by Sir Donald Irvine who noted about risk-based regulation in a medical context that it “(…) is not compatible with the concept of a guarantee to the public of a good doctor for all (...) need to demonstrate that it has the public’s fully informed consent if it decides to support this line. After all it is patients, not doctors, who may be killed or injured by poor doctoring”[30]. Thirdly, there is an expectation that a ‘scientific’ risk-based approach creates a high degree of certainty[31]– whereas in reality, even with highly sophisticated models, “the real-world market is far richer in attributes and causal complexity than any model or collection of

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[27]See BEAUSSIER - DEMERITT, et al (note 25).
[28]Ibid.
[29]See BEBCHUK - SPAMANN, *Regulating Bankers’Pay*’, (2010) *Georgetown Law Journal*, 247-248.
[30]See http://webarchive.nationalarchives.gov.uk/20130107105354/http://www.dh.gov.uk/prod_consum_dh/groups/dh_digitalassets/@dh/en/documents/digitalasset/dh_4132991.pdf.
[31]See MCCLOSKEY - ZILIAK, *The Cult of Statistical Significance*, University of Michigan, 2008.

models is able to capture".[32] This does not imply that more scientific approaches to assessing and addressing risk should be eschewed, rather we suggest that what is important is not to over-rely[33] on the sophistication of risk-based prioritisation, or to be blinded by the belief that it is always completely accurate in the selection of risks.

Disclosure-based regulation (which has been evident in the securities market) is characterized by the premise of 'caveat emptor' or 'buyer beware'. The emphasis within regulation here, is to ensure that regulated entities provide sufficient information to investors, consumers and stakeholders, so that the other party can make a rational choice without any paternalistic regulatory interference. Typically, disclosure-based regulation tends to be allied to a more rules-based approach to regulation, although this is not always the case.

The challenges with the disclosure-based approach lie not just in setting the quality, frequency, and depth of disclosure, but in how recipients of information may process or address information disclosed to them[34]. Firstly, where gross information asymmetries exist between stakeholders, investors, consumers and the regulated entity, these may be an unfair onus placed on the presumed rationality of the information recipient (that may be exploited) causing detriment[35]. Cases from the crisis of 2007 related to the sale of sub-prime mortgages are an important case in point[36]. Secondly, recipients of information may be subject to various biases and heuristics, which may impede their rationality and which may

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[32] Department of Social and Moral Philosophy, University of Helsinki, Purpose and Vision section of 'The Market and Marketization: Models, Mechanisms and Explanation', at http://www. helsinki. fi/market/purposeandvision.htm

[33] See ELLIOTT - ATKINSON, *The Gods That Failed: How Blind Faith in Markets Has Cost Us Our Future*, Nation Books, New York, 2009.

[34] See AVGOULEAS, *What future for disclosure as a regulatory technique? Lessons from behavioural decision theory and the global financial crisis*, in I. MacNeil and J. O'Brien, (eds), *The Future of Financial Regulation*, (Hart, Portland, 2010).

[35] See CROTTY, *Structural causes of the global financial crisis: a critical assessment of the 'new financial architecture*, (2009) 33 *Cambridge Journal of Economics*, 563-564.

[36] See KOTLIKOFF, *Jimmy Stewart is Dead: Ending the World's Ongoing Financial Plague with Limited Purpose Banking* (John Wiley and Sons, 2011).

be preyed upon by sophisticated marketers[37]. Thirdly, there is a presumption that those receiving the information are able and willing to act on behalf of all affected stakeholders. Scholars such as Villiers suggest that there is a misguided reliance on the role of corporate governance and responsible investors[38] who may neither be willing nor able to act as gatekeepers to the market.

Merit-based regulation requires regulated entities to allow the regulator to assess the merits and demerits of products and services that are introduced to the financial markets. The aim is to ensure a certain minimum quality rather than assure a consistent high quality in such offerings. Such merit-based regulation may take the form of pre-approval of new products, licensing of certain activities and so on. Merit-based regulation is deemed to increase fairness, justice and equity as it seeks to address challenges arising from informational imbalances, complexity and conflicts of interest by proactively ensuring the quality of offering within the financial markets.

Merit-based regulation is therefore a counter-point to more 'laissez faire' approaches to regulation and has attracted criticism[39] on the grounds that it restricts financial freedoms and that regulators are being presumptuous in assuming they possess the skill and knowledge to make assessments of suitability on behalf of all investors. Additionally, there is a cost-implication to the devotion of regulatory resources to such activities, which is often considered unjustified. Such costs are generally evaluated in terms of the regulatory burden to industry, rather than the wider societal consequences of introducing products which fail minimal tests for fairness and safety[40].

A judgement-based approach to regulation is consistent with a more principles-based approach to regulation as it affords regulators the possibility of assert-

[37]See CROTTY (note 35).
[38]See VILLIERS, *Has the financial crisis revealed the concept of the responsible owner to be a myth?*, in I. MacNeil and J. O'Brien (eds), *The Future of Financial Regulation* (Hart, Portland, 2010).
[39]See COLUMBO, *Merit Regulation via the Suitability Rules*, (2013) 12(1) *Journal of International Business Law*.
[40]See DRIVER (note 6).

ing their own judgement (typically evidence-based) to identify and address risks and challenge business models[41]. Its strengths and weakness are fairly similar to those of the principles-based approach more generally and its nomenclature has achieved prominence in the UK in the aftermath of the GFC[42]. It is worth pointing out that prior to the crisis regulators did exercise judgement while applying principles and rules; however, the focus on regulatory judgements now appears to highlight the increased emphasis on regulatory skill, expertise and active regulatory intervention/non-intervention that is meant to accompany UK financial regulation more recently.

Outcomes-oriented regulation is posited by regulatory practitioners as a corollary to principles-based regulation in that it seeks to structure regulatory attention around the broader achievement of regulatory outcomes as opposed to focussing upon the procedural steps that need to be followed by the regulated entity. While this may lead to a better appreciation of big-picture, longer-term considerations by both regulated entities and regulators, more nuanced shorter-term detriment might be neglected in the pursuance of the broader outcome. This approach to drafting principles and rules assumes that regulators understand the range of potential outcomes – both positive and adverse.

Outcomes-orientation is intended to encourage a broader-perspective on results for society and consumers. Rather than focussing on interim outputs (e.g. satisfaction scores), the aim is to focus on what the overall outcome (e.g. has the customer been treated fairly?). Given that outcomes are at a high level it is a challenge for both regulators and regulated entities to operationalise how they will be achieved or assessed. Management information in turn is often difficult to define, obtain and assess, making it difficult for regulators to offer substantive evidence-

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[41]See TREASURY, *A new approach to financial regulation: judgement, focus and stability*, (July 2010) at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81389/consult_financial_regulation_condoc.pdf.

[42]See Prudential Regulation Authority, *The Prudential Regulation Authority's approach to banking supervision*, (April 2013) at http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1304.pdf.

based challenge. In larger or complex regulated firms, achievement of outcomes may arise from a multiplicity of functional areas; this makes accountability difficult to establish and also makes it harder for regulators to take targeted enforcement or supervisory actions. Organisational embedding of an outcomes-orientation is challenging, both within regulators and within regulated entities, because cultural changes to encourage big-picture thinking can be difficult to establish. A good example of this lies in descriptions of the early challenges experienced by the former UK regulator, the FSA, in establishing the 'Treating Customers Fairly' agenda in the UK[43]. Many of these problems are linked to are very similar to the broader challenges of adopting a principles-based approach to regulation.

Reliance is placed on regulated entities to demonstrate integrity and ethical conduct[44]. Such aspirations may at times remain unfulfilled causing wider stakeholder detriment, which is difficult to repaid. Finally, an outcomes-based approach is characterised in some jurisdictions by voluntary law enforcement where the markets can be regarded as rule-makers and governance requirements act as a surrogate for statutory norms. This may be at odds with the realities of both incentives and interests[45].

4. We will now discuss the practical implications of applying the above concepts. In recent years, the financial markets can be seen as the major cornerstone of the EU's strategy in terms of policy efforts. What has been achieved, ensues from the Financial Services Action Plan (FSAP)[46] and the numerous financial

[43] See FSA, *Treating Customers Fairly: Towards Fair Outcomes for Consumers*, July 2006.
[44] See BLACK - ROUCH, *The development of the global markets as rule-makers: engagement and legitimacy*, (2008) 2(3) *Law and Financial Markets Review*, 223-225. See also BENJAMIN, BOWDEN, ROUCH, *Law and regulation for global financial markets: markets as rule-makers – enforcement, dispute resolution and risk*, (2008) 2(4) *Law and Financial Markets Review*, 322-323; BENJAMIN - ROUCH, *The international financial markets as a source of global law: the privatisation of rule-making?*, (2008) 2(2) *Law and Financial Markets Review*, 82-83.
[45] See CROTTY (note 35).
[46] In general terms, the FSAP was adopted by the Commission in 1999 to improve the single market in financial services. The programme is divided into four broad areas: retail markets; wholesale markets; prudential rules and supervision, and other aspects necessary to complete the financial market. Briefly, the FSAP is inserted into the 'Lamfalussy Reform', that provides a single set of

directives that the EU Institutions have adopted with a view to reforming the securities sector. A brief analysis can be made as to why the EU legislator adopted this huge financial architecture.

First, it appears that the perceived need for better regulation and consumer protection has driven the EU's strategy, also under the influence of the real integration of the markets which has occurred. Particularly, evidence of a desire to remove the existing national barriers as between Member States has marked certain directives, for example the Markets in Financial Instruments Directive (MiFID)[47] and the Markets in Financial Instruments Regulation (MiFIR)[48], which is considered to be the centrepiece of the FSAP[49]. This assumption can be measured by the growing need for harmonised securities regulation; in fact, a common set of rules at international level has definitively replaced the former local rules and administrative burdens (costs of cross-border financial activities, such as permissions, licenses and authorities' approvals). The effective consequence is the adoption of shared rules and forms of "soft law"[50].

Secondly, these new forms of regulation have been reflected in a self-regulation regime[51] characterised by internal controls, best practices, compliance and

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rules for Member States through a complex structure of four levels (for this point, see the analysis of WELCH, *European Financial Services* in M. Blair QC, G. Walker (eds), *Financial Services Law*, 2006, 762.

[47]See Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ 2004 L 145, p. 1). The Directive has been replaced by Directive 2014/65/EU (MiFID 2) (OJ 2014 L 173, p. 349).

[48]See Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

[49]The fifth recital in the preamble to MiFID stresses that "it is necessary to establish a comprehensive regulatory regime governing the execution of transactions in financial instruments irrespective of the trading methods used to conclude those transactions so as to ensure a high quality of execution of investor transactions and to uphold the integrity and overall efficiency of the financial system".

[50]Soft law signifies here a form of non-binding rules constituted by legal opinions, statements, guides, protocols, and commentaries. These forms have no legal force, but can influence the Courts and market participants.

[51]On the significance of self-regulation regime, see BLACK, *Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a "Post-Regulatory World*, in M.D.A. Freeman (ed), *Current Legal Problems*, 2001, Vol. 54, 112-113.

"treat customers fairly" programmes[52]. At first glance, the complexities of the regulatory system result in fragmentation and a substantive confusion of accountability; indeed, the principles adopted to regulate the markets do not seem to operate in a clear manner. In the last few decades, rule-making has been considered to be too slow to keep up with innovation in the sphere of financial instruments (for example, in the case of derivatives) and has been relegated to the same level as principles, with the inevitable confusion of their respective roles. The former Financial Services Authority (today Financial Conduct Authority and Prudential Regulation Authority) has put greater stress on the use of principles-based regulation, while affirming that this kind of approach "means moving away from dictating through detailed prescriptive rules and supervisory actions how firms should operate their business"[53].

The viable solution could lie in the compliance function as a rule of financial fairness and a form of enforcement measure. But the role of compliance must be accepted as a proper legal function, generally, by markets and, in particular, by firms; in substance, the function of compliance can be explained as an expression of self-regulation - because it is accepted by market participants - with substantive legal content[54]. In addition, the difference between principles and rules is to be found in the role attributed to the latter: compliance with rules is itself a form of rule, while principles represent the first stage of rule adoption. For example, principles are used to treat the market fairly with a set of best practices; compliance is used to enforce the best practices and becomes in the final analysis a rule in the sense of *jus cogens*. Firms and companies have recognised the importance of compliance, particularly as regards internal controls (the audit committee), where the

[52]See FSA (note 43).

[53]See Financial Services Authority, *Principles Based Regulation: Focusing on the Outcomes that Matter*, April 2007, 4. For a critical view, see C. Conceicao and R. Gray, 'Problems of uncertainty' (2007) 26(6) *International Financial Law Review*, 42-43.

[54]See DRISCOLL, HOFFMAN, MURPHY, *Business Ethics and Compliance: What Management Is Doing and Why?*, (1998) 99(1) *Business and Society Review*, 39. It is suggested that compliance is strictly related to business ethics, in terms of good faith, due diligence and moral conduct whose aim must be to reduce the risk of bad reputation in the firms; however, to achieve this goal, corporate governance must act with responsibility, while seeking to avoid breaking the law.

relationship between administrators, managers and investors finds its best expression in a species of self-imposed rules designed to reduce the risk to the firm itself[55].

Lastly, technological innovation and the transformation of the financial markets have brought about huge changes in terms of regulation, particularly in comparison between the EU and the UK strategies. On the one hand, the EU strategy has laid the foundation for a new way of dealing with the securities sector, which is characterised by consumer protection and an investor-disclosure system[56]. On the other, the UK strategy has launched the 'outcomes-based' regime governed, not only by rules but also by principles, which have to be correctly interpreted. In this context, it is possible to observe that the connection between those two kinds of strategy can be found in the role and function of compliance: in the EU system, there is an early stage of compliance, recently revitalised in the MiFID, whilst in the UK system compliance is already extremely highly developed. However, that system of compliance provided for by MiFID would have sparse efficiency in the UK, since it is not viewed as a self-regulatory measure with legal force, but rather as an additional burden for firms[57].

5. The most recent securities market reforms (the MiFID 2 in the EU system and 'principles-based' regulation in the UK) have constituted an important innovation in terms of regulatory approach and financial stability. However, the two systems with their different features, are still considered separately; in fact, the EU

[55]See NEWTON, *The Handbook of Compliance: Making Ethics Work in Financial Services*, London, 2002, 75. The central point is that compliance represents an integral part of the internal process of controls and can contribute to limit the risk of a collapse in trust.
[56]A complete and exhaustive analysis of investor protection regulation is provided by MOLONEY, *How to protect investors: lessons from the EC and the UK* (Cambridge University Press, 2010) 296-297.
[57]See MOLONEY, *Effective Policy Design for the Retail Investment Services Market: Challenges and Choices Post FSAP*, in G. Ferrarini and E. Wymeersch (eds), *Investor Protection in Europe: Corporate Law Making, the MiFID and Beyond* (Oxford University Press 2006) 411-412.

legislation - namely the 'de Larosière'[58] process and the Banking Union architecture[59] - appears, from a UK perspective to constitute a legal obstacle to rule-making by the FCA. It has been pointed out that "the risk of principles-based regulation in the EU context is thus simply the risk of implementation of Principles at the national level moved up to the supranational level"[60]. Specifically, the major criticism starts from the premise that the MiFID 2 has imposed a detailed and burdensome system of rules into or on top of the UK Principles system. In contrast, the key point to stress is the fact that both systems incorporate a 'principles-based' regime (in the case of the EU as an instrument for harmonisation among Member States). It is possible to argue that there is a worthwhile link between the two regulatory strategies and that the EU and the UK have adopted the same framework in different institutional contexts.

The major elements are the use of self-regulation and a mixed rules-based and 'principles-based' regime with the compliance function acting as the enforcement measure.

Firstly, both the EU and the UK financial markets legislation adopt a form of self-regulatory approach. With the MiFID Directive, the Community legislator has introduced a set of provisions clearly characterised by voluntary conducts on the part of business (for instance, the suitability regime and best execution) that delegate to market participants the power of behaviour control, while the UK legislator has recently reinforced its attitude with regard to self-regulation by enhancing the mentioned 'outcomes-oriented' regime.

As indicated, one of MiFID's fundamental goals is harmonisation as between Member States and the introduction of an enhanced single framework of provisions. It can be pointed out that the MiFID has created a single system for cross-

[58]See DE LAROSIÈRE, *The High-Level Group on Financial Supervision in the EU Report*, Brussels, February 2009.
[59]The design of the Banking Union has determined a transfer to the European Central Bank of the regulatory and institutional framework for safeguarding the integrity and stability of the banking and financial sectors. In particular, the Banking Union introduced a common platform for regulation of supervision; resolution mechanisms; and deposit insurance.
[60]See BLACK, HOPPER, BAND (note 12) 196.

border transactions with an efficient integration of securities products in which market participants are clearly accountable for their acts. In particular, the new classification of clients (i.e. retail, professional or eligible counterparty) has produced a remarkable disclosure regime, combined with a high level of consumer protection. In this way, the principles of good faith, trust and fairness are embodied in intermediaries' behaviours. It may be noted in this context, moreover, that the investment advice having to be given to the client during the business operation can be compared to the eleven Principles for Business set out in the FCA Handbook[61]. In this context, the appropriateness and suitability test (MiFID, Art. 19) constitute the concrete application of best practices; consequently, the UK principles find their application in a common ground of mutual rules established by EU legislation.

Secondly, it is possible to observe that there is a relationship between the regulatory regime of MiFID and the FCA's rule-making, since both use a mixed system of rules and principles. Closer examination prompts a number of observations: the UK regulatory system leaves to principles the power to regulate firms' behaviours, which means that the securities market regulates itself through internal management controls and the monitoring of the FCA. In substance, the principle is regarded as a general rule, or a second level of statutory norm that deploys its legal force under the risk of misconduct and a risk of non-compliant behaviours; as a result, whereas the principle ensues from a decision by the Authority, market participants have to play an active role in ensuring that it is effective. In other words, the UK system is characterised by self-induced regulation through flexibility of principles, monitoring of management behaviours and a system of internal controls[62].

In the same vein, but in a different institutional context, the MiFID establishes principles within its prescriptive provisions; the principle is inserted into the

[61]See https://www.handbook.fca.org.uk/handbook/PRIN/2/1.html.

[62]See BALDWIN - BLACK, *Really Responsive Regulation*, *LSE Law, Society and Economy Working Papers No 15*, 2007, 3-4.

norm, thereby bringing about a mixed system where self-regulation is combined with normative regulation. For example, the conduct of business provided by Articles 19, 21 and 22 provides for the "investment advice or personal recommendations regime" and requires a set of ethical principles in order to ensure that "an investment firm acts honestly, fairly and professionally in accordance with the best interests of its clients"[63]; in short, the principle is at the same time a statutory norm.

Thirdly, both regimes promote the culture of compliance as an incentive to prevent risk-taking and provide legal liability, particularly, in terms of an adequate level of enforcement of principles; however, it has been argued that 'self-induced compliance in the UK system can sometimes determine inefficiencies of enforcement in respect of misconduct'[64]. Whereas the institutionalised compliance provided for in the EU system acts as a form of supplementary (more stringent) enforcement, both combined with the statutory norm operate through *ad hoc* internal corporate bodies (internal audit committees). In this regard, the possible risks of compliance failures consist, on the one hand, of creative compliance (i.e. where although the spirit of the norm is adhered to, it is sometimes interpreted over-generously) and, on the other, of over-compliance (i.e. over-regulation or additional burdensome levels of enforcement).

The compliance function can be well-functioning on the basis of trust and fairness behaviours, which means confidence, transparency and cogent acts[65]; in other words, substantive compliance represents the key objective for fostering responsive regulation. In sum, recent financial events have shown how the UK system - albeit having a highly developed principles-based regime - has been charac-

[63]See MOLONEY, *Financial Market Regulation in the Post-Financial Services Action Plan Era* (2006) 55(4) *International & Comparative Law Quarterly*, 986-987.

[64]See WHITTAKER, *Better regulation – principles vs. rules*, (2006) 21(5) *Journal of International Banking Law and Regulation*, 236.

[65]Transparency construed as a clear understanding of roles, functions, powers and responsibility; in this sense, compliance acts as a congruent instrument for enforcing principle in conformity with the rule. See DIVER, *The Optimal Precision of Administrative Rules*, (1983) 93 *Yale Law Journal*, 67-68.

terised by a species of creative compliance in terms of superficial controls and according solely with the surface content of the rule[66]. In contrast, the EU regulatory system has developed a form of substantive compliance (according not only with the letter, but also with the spirit of the law), protected by corporate mechanisms of controls and structured within the legal platform of the MiFID. Finally, it can be argued that the implementation of the EU Directive in the UK Conduct of Business has determined an innovative change in terms of transparency and responsibility to financial consumers[67].

6. Questions of legitimacy and accountability are linked to the utmost degree with consumer protection policy[68]. In this regard, the UK system has set out, in sections 3-6 of the Financial Services and Markets Act 2000 (FSMA 2000), significant regulatory objectives, such as market confidence, public awareness, consumer protection and reduction of financial crime, together with adequate consumer regulation[69]. Market confidence can be considered the key objective, in terms of investor protection, on account of its fundamental role of achieving soundness of the financial markets. Consequently, by avoiding the legal risks, the market reduces the risk of failures (and hence of reputational risk).

The important aspect is that of correcting imbalances of information between producers and consumers of financial services. A controversial question is whether the UK legislation affords an adequate level of consumer protection; indeed, it can be observed that, whilst on the one hand section 5(1) of FSMA 2000 ensures "an appropriate degree of protection for consumers", on the other, section 5 (2) provides that "in considering what degree of protection may be appro-

[66]In particular, a case of non-compliant behaviours has been analysed by BLACK, NOBLES, *Personal Pensions Misselling: The Causes and Lessons of Regulatory Failure* (1998) 61(6) *The Modern Law Review*, 799-800.

[67]FSA, *Organisational Systems and Controls – A Common Platform for Firms*, CP 06/9, May 2006, 13-14.

[68]See MOLONEY, *Confidence and Competence: The Conundrum of EC Capital Markets Law*, (2004) 4(1) *Journal of Corporate Law Studies*, 11-12.

[69]See FISHER, BEWSEY, WATERS, OVEY, *The Law of Investor Protection* (Sweet & Maxwell, 2003) 18.

priate, the Authority must have regard to (d) the general principle that consumers should take responsibility for their decisions". In this regard, it has been observed that "an evident lack of certainty and clarity underscores the limits of the UK consumer protection system"[70]. By contrast, the EU legislation with MiFID has imposed a stringent assessment of investor guarantees through "the fair presentation of investment recommendations and the disclosure of conflicts of interest"[71].

Broadly, legitimate and accountable regulation prevents the potential risk of confidence failure and promotes a clear understanding of consumer protection law; in this context, an innovative challenge has been set by the Office of Fair Trading, a government agency appointed to improve the consumer protection legislation through informative leaflets or booklets, guidance and publications of best practices[72]. The English Courts have made appreciable advances in terms of consumer protection by confirming the tendency to consider consumers as an active part of financial markets[73]; particularly in the banking sector, the promotion of banking codes of best practices (The Banking Code and Business Banking Code, March 2008) has demonstrated an important change in policy towards consumers.

The need for proper supervision system in the securities sector which should enhance efficient regulation by EU regulators and domestic authorities is manifest; the current financial instability has underscored the existence of a complex, confused structure characterising the approach to supervision, not only at European level, but also at national level. In order better to appreciate how this could be resolved by moving towards a single financial supervisory system, fundamental developments must be taken into account.

Recently, there has been a constructive debate involving the EU institutions, scholars and commentators as to a possible approach to supervision under the

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[70]See BENJAMIN, *Financial Law* (Oxford University Press, 2007) 590.
[71]See MiFID Directive Level 2 (2006/73/EC), recital 28.
[72]See HARVEY - PARRY, *The Law of Consumer Protection and Fair Trading* (London, 2000) 50-51.
[73]See *Office of Fair Trading v Abbey National and others* [2009], EWCA Civ 116; the High Court stressed the question of unfair commercial practices while affirming the centrality of reasonable consumer expectations.

Banking Union which could be capable of preventing the risk of market failures. In particular, recent proposals have shown a clear preference for establishing an integrated structure to coordinate cross-border bank supervision and resolution[74]. This proposal stems from past experience with different supervision models, such as the institutional model, the functional model and the integrated model[75]. The proposed scheme, which would have characteristics of its own, would reflect the main purposes of the supervision function: prudential supervision, ensuring the financial stability of whole securities sector and the conduct of business supervision, combined with disclosure and investor protection systems incorporated in the internal management controls[76].

The financial supervision architecture is moving from an institutional and functional model towards an integrated approach where the role of national authorities is coordinated by one independent single network of financial supervisors; in this manner, a clear distribution of roles and functions between financial regulators will make for integrity and uniformity of acts[77]. For example, in terms of accountability, a clear division of responsibilities was set out in the 'Memorandum of Understanding', which allocated the different functions among the Treasury, the Bank of England and the FSA[78].

Under the European Banking Union there has been a strong call for an ongoing dialogue between institutions and a constant exchange of information

[74]The establishment of a single, unique safety net within the Banking Union would also address the 'vicious circle' between national governments and banks. A notable pillar of the new legislative structure is the resolvability system for bank crisis. The Bank Recovery and Resolution Directive (2014/59/EU) and the Single Resolution Mechanism (Regulation No 806/2014) aim at ensuring that failing financial institutions can be resolved in an orderly and uniform manner in the Eurozone.
[75]See WYMEERSCH, *The Structure of Financial Supervision in Europe: About Single Financial Supervisors, Twin Peaks and Multiple Financial Supervisors*, (2007) 8(2) *European Business Organization Law Review*, 242-243.
[76]The distinction between prudential supervision and conduct of business supervision was formulated by TAYLOR, *Twin Peaks: A Regulatory Structure for the New Century*, Centre for the Study of Financial Innovation, London, 1995.
[77]See BRIAULT, *The Rationale for a Single National Financial Services Regulator*, FSA Occasional Paper Series No 2, London, 1999, 18-19; 'Revisiting the rationale for a single financial services regulator', FSA Occasional Paper Series No 16, London, 2002, 21-22.
[78]See Treasury, Bank of England, FSA, 'Memorandum of Understanding for Financial Stability', March 2006.

amongst the individual supervisory authorities. Manifestly, this objective could be achieved with an integrated supervision approach under which the supervisory function should be effective, transparent and accountable to the political institutions. Concurrently, it has been argued that "a single financial market needs a single financial supervisor with a set of harmonised supervision powers"[79]. It can be cogently observed that such a supervisory solution would supply a plausible, definitive solution to the risk of monitoring loopholes and provide a response to the emergent co-operation between national supervisors and European regulators. It can also be reasonably noted that a strong improvement of risk management, together with the enforcement of internal compliant behaviours, should be implemented when tackling the new challenge of the reform of supervision. In other words, in introducing a single supervisory body it is necessary to implement continuing co-operation and coordination of functions with a permanent dialogue between national and European authorities[80].

Effective reform of financial market should entail a radical change in corporate behaviours. In order to achieve this goal, a proposal for substantive compliance as a response to judgement-based and principles-based regimes may be significant in the long run.

In this way, the compliance function not only assumes a normative value, but also constitutes a useful measure for enforcing principles; in other words, substantive compliance is instituted by means of compliant management[81]. Logically, this new way of regulation would require responsive behaviour of market participants and would involve forms of self-enforcement; also, however, it would introduce a concept of responsible management characterised by capability and the ability to combine "the versatility and flexibility of voluntary self-regulation,

[79]See DAVIES - GREEN, *Global Financial Regulation* (Cambridge University Press, 2008) 255-256.
[80]See FERRAN, *Capital Market Competitiveness and Enforcement*, European Corporate Governance Institute (paper produced for the City of London Corporation, 2008) 2-3.
[81]See PARKER - NIELSEN, *Corporate Compliance Systems. Could They Make Any Difference?*, (2009) 41(1) *Administration & Society*, 8-9.

avoiding many of the inherent weaknesses of voluntarism"[82].

A system of internal controls represents the most important element of independence and trusteeship, which helps achieve market confidence and accountability; however, in order to promote substantive compliance there must not only be support from management but also a commitment to statutory legislation. The idea of substantive compliance, in a merit-based regime for example, does not seek to diminish the significance of the risk-based and principles-based approach, but sets out to make corporate securities participants an active part of the self-regulation decision-making process.

In order to achieve more participative regulation on the part of market actors, the compliance culture should facilitate less intrusive statutory intervention. As has been argued "governments may achieve greater compliance by engineering a regulatory system in which they themselves play a less dominant role, facilitating the constructive regulatory participation of private interests, and relying on more or less naturally occurring regulatory orderings"[83]. This will entail the involvement of compliance in the formation of the self-regulation regime and in the statutory law-making process. In sum, substantive compliance necessitates the existence of a strong link between rules and principles and can be regarded as being a characteristic of self-induced regulation and enforcement in the EU and UK context. For instance, in the European securities system, compliance is provided by statutory norms (i.e. MiFID) and monitored by Community law; whilst in the UK financial structure, compliance is managed under the responsibility of senior management, on the basis of the FCA's principles and is left to the firm's internal controls[84].

The effectiveness of internal controls can allow action to be taken against behaviours amounting to misconduct and can permit a sound system of risk man-

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[82]See AYRES - BRAITHWAITE, *Responsive Regulation. Transcending the Deregulation Debate* (New York, Oxford University Press, 1992) 106.
[83]See GRABOSKY, *Using Non-Governmental Resources to Foster Regulatory Compliance*, (1995) 8(4) *Governance: An International Journal of Policy, Administration and Institutions*, 543.
[84]See ALEXOPOULOS - LINSLEY, *Senior Management Responsibilities*, (2000) 15(3) *Journal of International Banking Law*, 68-69.

agement to be applied. In addition, the implementation of substantive compliance enables best practices to be incorporated into the market-based regime, which will result in a new system of governance of the securities market. It has been pointed out that "in the compliance context, new governance permits a dynamic and continually re-evaluated internal understanding of compliance"[85]. Principles improve voluntary norms and self-enforced behaviours and provide an incentive for the daily mechanisms of management control. Lastly, a possible path of financial reform could consist in improving effective fairness in respect of business conducts so as to reduce the reputational risk of the firm. This means better regulation[86] in terms of substantive compliance culture and an active role on the part of market participants.

The movement towards a risk-management culture, based on voluntary forms of regulation, has definitely changed the regulatory strategy of securities governance[87]. In particular, the establishment of induced moral corporate practices, under the compliance watchdog, has altered the spirit of the 'principles-based' regime: from ethical and formal behaviours to enforced effective norms of conduct. The successful use of principles over rules has raised an important question: how to provide an adequate enforcement measure to counter the legal risk[88] of a failure of internal controls. In this connection, the system of members' credibility has proved to be inefficacious for ensuring that fairness and good faith are properly applied. The role of the compliance function, as an ex ante legal measure to prevent the risks of statutory enforcement loopholes, becomes an important

[85]See FORD, *New Governance, Compliance and Principles-Based Securities Regulation*, (2008) 45(1) *American Business Law Journal*, 28. It is argued that "a new governance-style, principles-based approach has a special relevance to firm compliance functions, meaning those policies, processes, and systems that firms themselves must have in place to prevent and detect internal wrongdoing and violations of law".
[86]See FSA, 'Better Regulation Action Plan', CP 05/10, December 2005; FSA, 'Better Regulation Action Plan. Progress Report', June 2006. From an academic view see R. Baldwin, 'Is better regulation smarter regulation?' (2005) 3 *Public Law*, 497-498.
[87]See ALFIERI, *The Fall of Legal Ethics and the Rise of Risk Management*, (2006) 94(6) *Georgetown Law Journal*, 1933-1934.
[88]See WHITTAKER, *Lawyers as risk managers*, (2003) 18(1) *Butterworth Journal of International Business and Finance Law*, 5-6.

link between the rules-based and 'principles-based' regulatory approaches by conveying these types of regulation into the risk-based regime. A risk-based approach entails the active participation of financial members, in other words, it entails making principles more concrete[89]. But risk management involves compliance (regulation of internal controls) and stimulates it in terms of the effective detection of non-compliant behaviours.

The 2007-09 financial crisis has revealed all the distortions involved in managing securities products, but, at the same time, it has altered the prevailing sentiment with regard to regulation into a recognised need for a mixed regime of principles and rules. In this context, the European legislation with its normative system enshrined in the MiFID Directive has imposed a new legal platform where principles and rules coexist and the monitoring function of internal management organisations is strengthened.

7. Despite the proliferation of various headline terms such as outcomes-oriented regulation and judgement-based regulation, the underlying approach within the practice of financial regulation is a morphed version of the principles-based approach where high level principles accompany a selection (sometimes a large selection) of detailed rules. To ensure their effective co-functioning, regulated entities and regulators need to develop a better shared understanding of which stakeholders could be affected by risks and the consequences i.e. the risk-to-whom question. An outcome oriented, judgement-based approach may better lend itself to the achievement of this alongside such a principles-based regime. But first and foremost, the exercise of good judgement is tied to regulatory intentions and commitment, and sufficient resourcing of regulators. The approach that efficiencies are only gained through a reduction in regulatory burdens for firms is a convenient myth when one considers the short and longer term costs posed by the

[89]See BLACK, *Mapping the Contours of Contemporary Financial Services Regulation* (2002) 2(2) *Journal of Corporate Law Studies*, 278-279.

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It appears to us that at least in the UK more attention must be paid to the development of a comprehensive safety culture within financial services, rather than a supposedly pragmatic non-zero-failure approach which could easily mistakenly create the legitimacy to eschew regulations and cause stakeholder detriment on an ongoing basis. More attention must also be paid to consider the allied questions of whether and how regulators could and should address the challenges posed by regulatory arbitrage, lobbying and revolving doors, which in turn could adversely affect the scope and implementation of regulatory approaches, no matter how well-intentioned they are to begin with.

CHALLENGES FOR EXPATRIATES RETURNING: MEASURES AND APPROACHES FOR A SUCCESSFUL REINTEGRATION OF EMPLOYEES IN FINANCIAL ORGANIZATIONS

Mirella Pellegrini* - Nunzio Casalino** - Vanessa Krause***

ABSTRACT: *The international mobility and the overseas assignment of employees as part of global operations are growing of importance for financial organizations. However, these organizational aspects can also bear risks for both the employee and the companies. They may cause problems that affect the performance, motivation, satisfaction and retention of employees in the organization, especially upon their return. Results from several global surveys confirm the existence of problems following the employees' return and highlight where action is still required. This article investigates the sources of such risks and provides a discussion about how enterprises can reintegrate their employees successfully. There is a specific focus on managerial measures, which can help financial organizations to prevent potential risks on the return of their employees. Furthermore, it emphasizes on which methods in particular can be useful in order to achieve a smooth reintegration of employees.*

SUMMARY: 1. - Introduction. - 2. Economic globalization and government of multinational organizations. - 3. Impact of internationalization and needs of financial companies. - 4. The expatriates' management. - 5. Potential hazards and threats. - 6. Preventive measures. - 7. Results of the in-

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*Full Professor of Economic Law and Regulation at LUISS Guido Carli University - Department of Business and Management, Rome, Italy (e-mail: mpellegrini@luiss.it).

**Associate Professor of Business Organization at LUISS Guido Carli University - Department of Business and Management, Rome, Italy (e-mail: ncasalino@luiss.it).

***Human Resources Advisor in International Mobility - Roland Berger München, Bayern, Germany (e-mail: vanessa.krause@rolandberger.com).

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vestigation. - 8. Conclusions.

1. International assignments for executives and middle managers can provide a crucial contribution to organizational success in global financial organizations[1]. In the course of global growth, the number of international projects and activities is increasing steadily. The number of expatriates has risen by 25% in the past ten years and is considered to continue growing according to a regularly carried out survey on global mobility by the personnel consultancy company ECA International[2]. This arises due to the need of enterprises to provide qualified staff in the right place at the right time. From the perspective of an employee, the assignment represents an important progress within their career.

Many times, it generates a unique chance both for the professional and personal development. Nowadays, international transfer programs are also utilized as part of talent management strategies. Through gaining work experience abroad, the employee is supposed to seek required skills for future tasks or positions[3]. A global survey on the added value of global mobility carried out by PwC and the Cranfield School of Management[4] has shown that the importance of an assignment itself is recognized by financial organizations. Unlikely, a yet mostly under- estimated risk results from the return of employees who have been sent abroad. Employers assume potential risks on leaving the own country and dealing with the challenge of adapting to new cultures and conventions[5]. However, the integration in the home country after an assignment abroad rarely raises worries from the sides of employer or employee. The reintegration of employees on their return as

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[1]See CAPRIGLIONE, CASALINO, *Improving Corporate Governance and Managerial Skills in Banking Organizations, International Journal of Advanced Corporate Learning (iJAC)*, Austria, vol. 7, issue 4, pp. 17-27, 2014.

[2]https://www.eca-international.com/news/press_releases/7727/#.Vf2DKpf8aFs (online, 2015).

[3]Personal Manager 2014, p. 109: http://www.datakontext.com/download/Personal_Manager_1-2013/page7.html#/0 (online, 2015).

[4]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (available online, 2015).

[5]See CASALINO, MAZZONE, *Externalization of a banking information systems function. Features, regulatory and critical aspects, in The Interdisciplinary Aspects of Information Systems Studies*, D'Atri A., De Marco M., Casalino N. (Eds.), Physica-Verlag, Springer, Heidelberg, Germany, pp. 89-96, 2008.

part of a successful assignment is still largely neglected and therefore constitutes a major concern for financial organizations[6]. The pursuit of a successfully completed assignment requires an efficient reintegration of the former expatriate. Lower personal and professional burden during and after the return will affect higher satisfaction and better performance within the new field of work. As a result, satisfied employees will bring valuable contributions and higher retention to the organization[7].

2. The progressive intensification of economic and political relations between Countries that occurred in recent decades - has interacted on the organization and operation of financial companies involved in the capital markets, at the moment favouring an accentuated integration between them. It is given an occasion for new growth opportunities worldwide[8]; without prejudice to the need to proceed to appropriate technical analyses to highlight and resolve the problems that financial firms face, given the difference in growth rates between them, arising from the differences you want the real economy, the mode in which you want find expression in its investment policies and development[9]. In the context outlined, it reveals the positive effects of the information revolution and of the abatement of costs of goods and passenger transports[10]; hence the emergence of

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[6]See WEISE, 2003, 'Zeit online': http://www.zeit.de/jobletter/html_jl_40_01 (online, 2015).

[7]See LADWIG, LOOSE, *Globalisierung und Auslandseinsatz*, in *ZfP – Zeitschrift für Personalforschung*, Mering, p. 366, 2000.

[8]See ASSO, *Globalizzazione reale e globalizzazione finanziaria: aspetti teorici e problemi di regolamentazione*, in *Ragion pratica*, X, 2002, n. 18. We recognize the validity world economic order that find in the management of monetary and economic relations (IMF, General Agreement on tariffs and trade-GATT, World Bank) to what deputies. In fact, it is evident, that the realization of the "single currency", on the one hand, and the historical crisis of the communist regime, on the other hand, suggests the time is ripe for a redefinition of reality in question, after clarifying the roles and responsibilities of persons who, in the new international environment, are likely to play important functions.

[9]See PRASAD-ROGOFF-WEI-KOSE, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence*, LMF Occasional Paper, no. 220, 2003. See CAPRIGLIONE, *Evoluzione della disciplina di settore*, in AA.VV, Manuale di diritto bancario e finanziario, Padua, 2015, p.87.

[10]Thanks to the evolution of computer techniques, we see the development of new forms of trade in "cyberspace": on this issue see. RIFKIN, *L'era dell'accesso*, Milan, 2000, p. 22 ss.

a «new middle class» without local roots, accustomed to the lifestyles of «liquid modernity»[11]. This phenomenon is becoming the foundation of the government of the multinational organizations, the real protagonists of the global economic expansion. The latter, in view of their size and extension of the operating cross-border, implement a rapprochement between different realities, together with an increase in competition (although sometimes characterized by the presence of non-negligible risks that accentuate the danger of market turbulence). It cannot be neglected, however, to consider the implications arising from the growing irregular migration; making it difficult to create common development conditions. It should also be noted that globalization gives impetus to financial innovation, leading to significant interdependencies between financial operators; hence the spread of a business model that tends towards standardization of structures in uniform functional objectives[12]. This situation is evident especially in the presence of interconnected structures-state on the basis of rules to be followed by countries acceding to the treaties in which these rules are set. typical expression of this reality is the European regional context, governed by all the treaties that have followed from those of Rome (establishing the CEE) to end with the two treaties of Lisbon of the millennium (TUE and TFUE) with whom it was redefined in a modern way the "institutional triangle" which, as is well known, characterized the political / government summit of the European Community. It should be added that, in reality outlined, there is a downsizing of the public sphere, given the emergence of a new economic constitution based on the principles of competition and the market. It is clear, also, how the transformations of globalization are ever in the international financial system should call upon the search for ever higher levels of efficiency that is reached is increasing competition among intermediaries, it is taking a more sophisticated forms of risk reallocation. It follows an acceleration of the "financializa-

[11]See BAUMAN, *La modernità liquida*, Bari, 2002.
[12]Thus emphasizes the contours of globalization MONTEDORO, *Attualità di Carl Schmitt nella lettura di Giannini e Nigro, in www.giustizia-amministrativa.it*, and references therein.

tion" of the economy process, which is accompanied by an "international portfolio diversification" and a boost to investors' use of intermediaries professionally dedicated to asset management"[13]. In this operating environment there was an increase in production and consumption, adequately supported by the increased mobility of savings and a significant contribution of capital investment; hence the reflection of an authoritative doctrine that considered this process, the emergence of "considerable growth opportunities ... (intended to be compensated) ... the shortcomings global economic governance mechanisms"[14].

3. Intensification of the financial reports referred to above has been said is derived, in the case of countries which are in different conditions, the accentuation of addictive conditions of some against others. This can often result in a risk of financial instability due to possible amplification of the imbalances that operations across multiple markets can determine. It follows that the internationalization of financial companies is closely linked to the management of globalization; This is because, in the latter, is connected to any possibility of recovery of weak economies and, more generally, the start-up phase of development (and, with these, the achievement of social goals through a more equitable distribution of the planet's resources)[15]. Of course, the liberalization of trade and financial flows to envisage in a global context accentuates the opportunities offered to the least developed countries: so that, they will be eligible for benefits not otherwise anticipated. Clearly, then, as the global market will reclaim the search for rules of conduct aimed at the implementation of economic and financial mechanisms efficient and at the same time characterized by fairness. This rule of conduct, projected in an international context, calls for action geared to the operational transparency and re-

[13]See PONTOLILLO, *Globalizzazione, finanza ed etica*, lecture nell'Almo Borromeo College, University of Pavia, November 13, 2003, par. 1.3; PELLEGRINI, *Le controversie in materia bancaria e finanziaria*, Padua, 2007, passim, esp. Cap. I.
[14]See CAPRIGLIONE, *Evoluzione della disciplina di settore*, op. cit. loc. cit.
[15]See ONIDA, *La globalizzazione aumenta o riduce disuguaglianze e povertà?*, in The Mill, 2002, n. 1.

spect of the counterparties, made in a framework that qualifies for the professionalism of intermediaries and from the ethics of setting to play. That said, it should outline the disciplinary lines concerning the role and functions ascribed to the financial intermediaries of the European Union countries, if they devote themselves to an international activity. On this point, they should highlight the trends that characterize the sector's regulation: a) a first trend is towards a comprehensive scheme covering all profiles of financial intermediation and securities, hence the submission to reserve activities before freely exercisable; b) a second materialized in a growing emphasis to secondary regulation issued by the sector authorities[16], where the primary - as is known - must be limited to the determination of principles, and the allocation of powers able to guarantee the rapid adjustment of the interventions authoritative which is subject to changes in the reality of the sector, limiting the primary one to be fission instrument of principles and allocation of powers (able to guarantee the rapid adjustment of the interventions authoritative which is subject to changes in the reality of the sector)[17]. Hence the consideration that only through the analysis of such disciplinary structure you can find the best operational forms that make up the banking and financial system and, consequently, in their conduct a detailed classification on the basis of the activities carried out. More specifically, the analysis should dwell on banking activity definition (and the Bank as the person to whom is reserved the exercise of banking activity) as conceived by the European regulator. The point is to consider the information contained in art.4, paragraph 1, of the Regulation (EU) 575/2013 (which together

[16]Just think, at that time, to the. February 21, 1991, n. 52, on the sale of corporate loans, to l. July 5, 1991, n. 143, which dictates a first supervisory framework on non-bank financial intermediaries, to the. March 7, 1996, n. 108, the brokers, the l. April 30, 1999, n. 130, on the receivables securitization companies.

[17]This applies, in particular, the introduction of the CD. Single supervisory mechanism, the mechanism of single resolution and harmonization of deposit guarantee systems that represent the three pillars of European Banking Union formed in 2014 in order to submit to a regulatory / supervisory system only (headed by the ECB), all countries belonging to the EMU; This system provides for the participation of the EU countries (extra Eurozone) who can voluntarily join in order to contribute to the creation of an effective banking and financial union in the European Union.

with Directive 2013/36 / EU is the cd. CRD IV package) in which the institution credit is conceived as "an undertaking whose business is to receive deposits or other repayable funds from the public and to grant loans for its own account", which is where the actual connection with the idea (common in the Italian legislation) of the bank based on the same management the people's savings and the provision of loans in the market[18]. It is clear, consequently, that in the identification of regulatory frameworks able to reconnect the activities of the banks is to respect the criteria of competitiveness, both the enhancement of internal governance and managerial skills of corporate officers. This results, in economic terms, the identification of the fundamental traits that distinguish the banking business: on the one hand, the management of financial resources (i.e. savings) of surplus agents, that can be held by the bank as part of an arc medium to long-term investment; on the other, the granting of loans to entities in deficit, which generally are associated with diverse types of maturities and rates of return[19]. It is evident that the supranational character of the services performed, the configuration of intermediaries medium-large often be traced as part of the international banking group structures have placed at the centre of the interventions of the European financial authorities ordering summit (European System of financial Supervisors, ESFS) the rules of operation, governance and management of intermediaries, called to ensure the pursuit of sound and prudent management and financial stability[20]. Finally, in the context outlined detect the specific functions assumed by the ECB following the construction of EBU (European Banking Union) in the field of supervision authorities on the significant (but not only) that are replaced (and in

[18]See PELLEGRINI, TROISI, *Gli operatori del mercato finanziario: regolazione e supervisione*, in AA.VV., Corso di diritto pubblico dell'economia, by Pellegrini, Padua, 2016.

[19]For an evaluation of the economic aspects of the banking business, see. SAUNDERS-CORNETT - ANOLLI - ALEMANNI, *Economia degli intermediari finanziari*, Milan, 2015, p. 309 ss.

[20]See, among others, WYMEERSCH, The European Financial Supervisory Authorities, or ESAs, in Rethinking Financial Regulation and Supervision in Times of Crisis, edited by Ferrarini, Hopt and Wymeersch, Oxford University Press, 2012, p. 232 ff.; QUAGLIA, The Regulatory Response of the European Union to the Global Financial Crisis, in Crisis and Control. Institutional Change in Financial Market Regulation, by Mayntz, Frankfurt / New York, 2012, p. 171 ss.

some cases are flanked) to those the national authorities operating in the Eurozone countries[21]. Indeed, the EU Reg. No. 1024/2013 and Reg. No. ECB. 468/2014 have predicted a net translation of supranational supervisory powers, since - from November 2014 - the ECB is directly responsible in cd. "Common procedures" (including detect matters relating to the issuance / revocation of banking and evaluation of qualified investments) for the entire Eurozone banking sector, as well as in ordinary supervisory procedures (regulatory, inspection and reporting) towards the European credit intermediaries cd. significant (presenting, i.e., structural features, dimensional and operational which end up affecting the entire European financial market)[22]. Full, then, the homogenization under legislation introduced by the banking provision of specific powers in the field of banking crises pertaining to the ECB and to the Single Resolution Board (set up at European level) that, as anticipated, aim at the creation of a system integrated at the supranational level for the management and for the resolution of any situations of financial and asset criticality of banks operating in the European regional context[23].

4. Expatriate management is part of International Human Resources and deals with assignments of employees to another branch office abroad within a global organization.[24] An expatriate can be described as an employee who is sent

[21]This applies, in particular, the introduction of the CD. Single supervisory mechanism, the mechanism of single resolution and harmonization of deposit guarantee systems that represent the three pillars of European Banking Union formed in 2014 in order to submit to a regulatory / supervisory system only (headed by the ECB), all countries belonging to the EMU; This system provides for the participation of the EU countries (extra Eurozone) who can voluntarily join in order to contribute to the creation of an effective banking and financial union in the European Union.

[22]For detailed information on the breakdown between banks "significant" and "less significant", see the ECB document, The list of significant supervised entities and the list of less significant institutions, September 4, 2014, available on www.bankingsupervision.europa.eu/ecb/pub/pdf/ ssm-listofsupervise dentities1409en.pdf

[23]Specifically, the discipline of *Single Resolution Mechanism* is governed by Directive 2014/59/EU and definitely enters into force in January 2016, including the so-called procedure. in bail to be applied in case of operator's banking collapse; see CAPRIGLIONE – TROISI, *L'ordinamento finanziario dell'UE dopo la crisi*, Turin, 2014, p. 81 ss.

[24]See KÜHLMANN, *Auslandseinsatz von Mitarbeitern: Praxis der Personalpsychologie*, Göttingen, p. 4, 2004.

from his home country to a host country for a limited period of time of at least one year based on a company specified assignment policy. Assignments differentiate from business trips or shorter project assignments as they would not include a change of a local residential.[25] From a temporal perspective, they can be divided into periods of recruitment of potential expatriates, preparation of an assignment, the phase abroad and finally the return of an expatriate. During this final phase both the organization and the employee face the challenge of reintegration in the home country.

Reintegration related to assignments can be defined as an active process of an individual's adaption to his homeland including his professional, personal and sociocultural environment. Due to a stay abroad in a foreign country assignments can cause an alienation of the own culture and lead to confrontations upon the return.[26] Many times the reintegration process in the homeland, in contrast to the integration process abroad, is widely underestimated by financial organizations. Consequently, expatriates are often prepared insufficiently for their return. In some cases, the difficulty of adaption at home will therefore be greater than abroad which can cause drastic effects on the professional and social environment of expatriates.[27]

In order to describe the process of return and which issues can occur, several theories were formulated. Fritz (1982)[28] shows the return of a former expatriate and eventually his family on the basis of a three phase model while he divides the reintegration into three parts. The first period named *'Anticipation'* describes the time before until the effective return, when the employee and his family if applicable start to build expectations about their return to the homeland. These ex-

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[25]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, p. 3, 2012.
[26]See LADWIG, LOOSE, *Globalisierung und Auslandseinsatz*, in *ZfP – Zeitschrift für Personalforschung*, Mering, p. 366, 2000.
[27]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp. 339-350, 2011.
[28]See FRITZ, *Wiedereingliederung höherer Führungskräfte nach einem Auslandseinsatz*, Mannheim, p. 27, 1982.

pectations are based on experiences before the stay abroad and impressions about the home country, which have been established and shaped during the assignment. Moreover, during this phase, people develop an anticipation of coming home. However, most of the time these expectations deviate from realistically occurring experiences of the return. When adapting to a foreign culture, the point of view about own standards and values can change which makes the adaption to the own culture even more difficult. This process can be described as a reverse culture shock and can appear during the second so-call *"Accomodation"* phase according to Fritz's model. Occurring problems that might have been initially displaced by predominant happiness can now convert into disappointment and dissatisfaction at unfulfilled expectations in the workplace or social environment[29]. Eventually the returnee feels misunderstood in his own country and reacts with anger and withdrawal. Depending on the assignment's duration and location the reverse culture shock may have differing effects of varying intensity on the individual employee.[30] Against this background, an organization should aim a most possible low extent of the mentioned difficulties of return. Thereby, from a company's perspective the employee shall be supported during his adaption process[31] in the home country in order to facilitate his return and reduce negative effects on his work motivation. Fritz calls the last phase of reintegration *'Adaption'* when the employee is reintegrated both in terms of his professional and social environment.[32]

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[29]See CAPRIGLIONE, CASALINO, *Improving Corporate Governance and Managerial Skills* in *Banking Organizations, International Journal of Advanced Corporate Learning (iJAC)*, Austria, vol. 7, issue 4, pp. 17-27, 2014.

[30]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 28-29, 2012.

[31]See CASALINO, CIARLO, DE MARCO, GATTI, *ICT Adoption and Organizational Change. An Innovative Training System on Industrial Automation Systems for enhancing competitiveness of SMEs*, Proceedings of 14th International Conference on Enterprise Information Systems – ICEIS, Wroclaw, Poland, Maciaszek L., Cuzzocrea A., Cordeiro J. (Eds.), INSTICC, Setubal, Portugal, pp. 236-241, 2012.

[32]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 47-49, 2012.

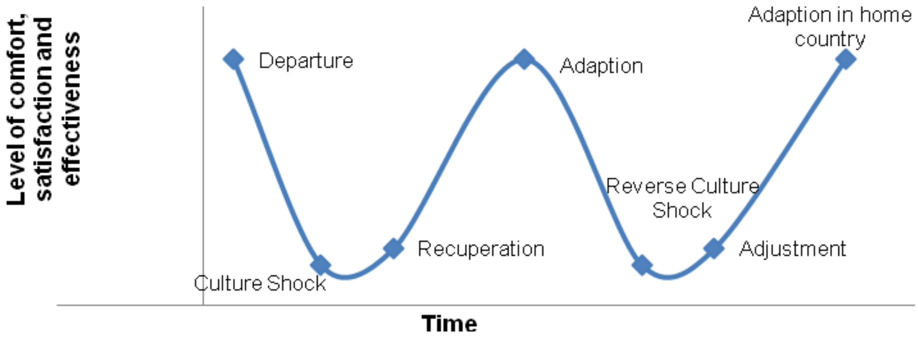

Fig. 1: W-curve model, reverse culture shock by Gullahorn und Gullahorn[33]

The reverse culture shock theory is based on the W-curve theory by Gullahorn and Gullahorn from 1963. It presents an extension of the U-curve theory by the American anthropologist Kalervo Oberg who analysed the original culture shock in a foreign country.[34] According to Gullahorn and Gullahorn, the employee relives another culture shock by the return to his home country, which is presented as a second curve in the figure showed above. At the start of the assignment, employees can experience a culture shock abroad, which causes a lower level of comfort, satisfaction and effectiveness. After recovering from this phase the employee adapts to the foreign norms and standards by which he feels more comfortable and satisfied. When returning to the home country the employee might experience a similar shock, the so-called reverse culture shock. As soon as the employee made it to completely adapt to his own country again, his level of comfort reaches the same level as of his departure again.

5. Risks that may arise with the return of an expatriate can affect his personal, social and professional reintegration[35]. For an organization, also the per-

[33]See HOLTBRÜGGE, WELGE, *Internationales Management. Theorien, Funktionen, Fallstudien*, Vol. 4, Stuttgart, pp. 423-430, 2006.
[34]See WEIDEMANN, *Akkulturation und interkulturelles Lernen*, Stuttgart, p. 489, 2007.
[35]See CASALINO, *Behavioural Additionality and Organizational Impact of European Policies to Promote Internationalisation of High-growth Innovative SMEs*, in *Journal of International*

sonal reintegration is of high importance, as the employee will have difficulties to fulfil the expected performance as long as his social reintegration will not be successful[36].

- Personal issues

The social reintegration process includes the completely private and family environment as well as psychological aspects. Since issues within the personal reintegration can have negative effects on the ability to perform well, they are worth of note for financial organizations. Due to a stay abroad, the social environment of an expatriate and eventually his family may change. Therefore, the reactivation of a former social network can become difficult. On the other side the risk of losing contacts or relations gained abroad can be experienced as a loss for expatriates when turning back home[37]. Also family members who accompanied the expatriate play a decisive role within the whole reintegration process. Especially partners who had no professional occupation during the stay abroad will face the challenge of finding a new job upon their return. Also for children, the reintegration can be the tough: besides general reintegration difficulties, they may additionally have to struggle with different systems and levels of achievement at school. All these challenges within the family can lead to tensions, which may affect the employee and his ability to perform. Moreover, the social reintegration includes an adaption to the former standard of living. Many times assignments are associated with social advancement and additional financial benefits. In this case returning to the home country means to accept a loss of privileges[38].

Furthermore, assignments involve the adaption to another culture's values. Depending on the degree of cultural differences between two countries, individu-

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Business and Economics, American Research Institute for Policy Development, USA, Vol. 2, No. 4, pp. 17-44, 2014.

[36]See FLESHMAN, 201, http://www.expat-news.com/1891/interkulturelle-kompetenzen-ausland/warum-expats-nach-der-ruckkehr-das-unternehmen-verlassen/ (available online, 2015).

[37]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp.339-350, 2011.

[38]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 18-19, 2012.

als change their own behaviour and point of view in a certain way. Obviously, assignments from Germany to Africa for example will include higher cultural differences than assignments within Europe. However, when experiencing a foreign culture the own norms and ways of behaviour will be considered more critical from the organizational point of view[39]. Given this fact, the adaption to the own alienated culture is often more difficult than on leaving a country to a foreign one. In addition, most of the time social integration problems are not expected when returning to the home country. Particular problems may arise if changed attitudes and point of views are not comprehended by the former social environment and returnees feel accordingly misunderstood[40].

- Professional risks

Upon on the return not only the expatriate's social environment but also his professional environment has changed which can lead to a number of problems. One of the highest challenges during an assignment is to keep in touch with former colleagues and superiors and keep up with the current scientific knowledge in the home country. An assignment survey carried out by Deloitte in 2008 investigated difficulties on the return of expatriates. As the survey has showed, one out of six enterprises lose more than a third of their repatriates within the first year after the return. According to those surveyed, the reasons for termination are above all dissatisfaction with the new position, difficulties to apply acquired skills and knowledge, followed by offers by other companies and experienced loss of status back in the parent company[41]. From a hierarchical point of view, the majority of expatriates take over more senior or leading positions during their assignment. Branch offices abroad are often smaller than the delegating head office and therefore al-

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[39]See CASALINO, D'ATRI, NORTH-SAMARDZIC, *ICT based means for automation and innovation*, vol., pp. 1-67, EKC-MPEC, Sofia, Bulgaria, 2011.

[40]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern, Saarbrücken*, pp. 18-20, 2012.

[41]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (online, 2015).

low expatriates more responsibility and decision-making indepen- dence[42]. On the other hand, in most cases the return implies a downgrading of their new position within an organization's hierarchy in the home country.[43] Furthermore, according to Festing, due to the acquired knowledge abroad repatriates expect a higher position within their delegating organization compared to the one before the assignment. If expectations towards the promotion will not be fulfilled, repatriates many times associate this with a lack of appreciation of their experiences and skills gained abroad. The theory says that this demotivation often leads to a termination by the employee. Another problem arises if the new position has not been determined by the time of the return. Festing argues that a lack of occupational safety causes uncertainty, insecurity and in the worst case isolation of an employee.[44] Similar to the social reintegration, the professional reintegration process bears a risk of a reverse culture shock, since the employee weans from certain working standards during his stay abroad. This may imply for example culture-bound differences in working hours or power structures between the branch office abroad and the head office in the home country[45]. From a professional point of view the return implies the challenge to adapt to different culture-bound principals which are lived in a company. Through the adaption to foreign working standards, the expatriate might start to question the ones in his home country upon the return. Many times this causes a feeling of being a stranger in the own country. Hofstede defined culture-bound differences within organizations as so-called "cultural dimensions". Hofstede describes culture as the collective programming of the mind which distinguishes the members of the human group from one another. By his

[42]See CASALINO, BUONOCORE, ROSSIGNOLI, RICCIARDI, *Transparency, Openness and Knowledge Sharing for Rebuilding and Strengthening Government Institutions*, in *Klement E.P.*, Borutzky W., Fahringer T., Hamza M.H., Uskov V., Proceedings of Web-based Education – WBE 2013 conference, IASTED-ACTA Press Zurich, 11-13 febbraio, Innsbruck, Austria, 2013.

[43]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, p. 22, 2012.

[44]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp. 339-350, 2011.

[45]See FLESHMAN, 2011, http://www.expat-news.com/1891/interkulturelle-kompetenzen-ausland/warum-expats-nach-der-ruckkehr-das-unternehmen-verlassen/ (online, 2015).

cultural dimensions' model, he shows to which extent behaviour and interaction of individuals from different cultures differ from each other and how this impacts on financial organizations. As the following figure shows, some countries including China for example, are shaped by a higher power distance than countries such as Germany. High power distance can be characterized by an authoritarian leadership style and large hierarchical levels. According to Hofstede's model, an employee who occupied a leading position in a country with high power distance will initially struggle to accustom himself to a position including less authority upon his return[46].

- Risks for the organization

From an organizational point of view, a smooth reintegration process is crucial for a successful completed assignment. The potential benefit of assignments can be endangered significantly in case of issues during the reintegration. One of the highest risks for financial organizations is to lose an employee after an assignment due to problems during the reintegration. According to Burghaus, the organization will incur excessive costs in order to fill the vacant position appropriately. Furthermore, a termination causes the necessity to compensate the lost know-how that was acquired abroad and the lost profit of an assignment[47]. Several studies have shown that problems during the return phase and terminations after assignments are strictly related: following an investigation by PwC in 2007 up to 15 per cent of the examined companies lost their expatriates within the first year after their return. Moreover, the fluctuation rate of repatriates was higher than of employees in comparable positions within the delegating organization. Following the surveyed companies and repatriates the main reasons for this are a lack of ca-

[46]See HOFSTEDE, *Interkulturelle Zusammenarbeit. Kulturen-Organisationen-Management*, Wiesbaden, p. 26-1993.

[47]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saabrücken, pp. 24-26, 2012.

reer planning and poor support during the reintegration[48]. Another survey carried out by Burghaus A. states that 88 per cent of all respondent companies consider finding an appropriate position for the repatriate as one of the most challenging tasks[49] for financial organizations. In particular, within upper management levels it can be more difficult due to a limited number of positions[50]. Depending on organizations and their assignment policies, contractual arrangements regarding the return of expatriates differ. In most cases, financial organizations arrange reintegration guaranties by which they are committed to continue to employ repatriates after their return without indicating a particular position. This is due to the fact that at the start of an assignment it is still uncertain how the personnel requirement will develop. As a result, there is a risk of not meeting the expatriate's expectations, which, on the other hand, is crucial to motivate the employee. Hofmann argues that it can be also risky to staff employees on positions, which do not correspond to their skills. Furthermore, potential demotivation of repatriates bears a risk of endanger the working atmosphere and the quality of relationships with colleagues and supervisors[51].

6. Preventive measures in the context of reintegration after assignments are supporting frameworks, which can help financial organizations to prevent potential risks already before the return of their employees. According to the organizational literature, the application of these measures is crucial for a successful assignment and reintegration process. Their effects have been studied within business fields such as in literature and consulting surveys. The following measures represent par-

[48]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (online 2015).
[49]See CASALINO, IVANOV, NENOV, *Innovation's Governance and Investments for Enhancing Competitiveness of Manufacturing SMEs*, in *Law and Economics Yearly Review Journal*, Queen Mary University, London, UK, vol. 3, part 1, pp. 72-97, 2014.
[50]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 24-26, 2012.
[51]See HOFMANN, ROHRBACH, *Internationaler Mitarbeitereinsatz. Gestaltungsalternativen-Praxisfälle-Prüfschemata*, vol. 3, Münster, pp. 81-84, 2011.

ticularly important strategies to prevent risks and ensure a positive reintegration process for expatriates[52]:

Repatriation planning - In organizational literature, it is well recognized that advance planning is the most effective way to initiate the reintegration process. Timely planning ensures financial organizations the possibility to prevent a number of problems in advance. Festing M. argues that reintegration will not be completed by the employee's return to the delegating office but as soon as he is able to fulfil his tasks and is satisfied with his new position[53]. In order to prepare the expatriate mentally for his return, it is crucial to point out potential issues within his social and professional environment after the return. Furthermore, repatriation planning implies organizational and financial support by the organization. For instance, this may include supporting the employee and eventually his family by organizing the relocation and house hunting. The purpose of these measures is to minimize the employee's personal stress caused by the reintegration process as far as possible. From a temporal perspective, financial organizations should start to plan the return of their expatriates at least 9 months before. During this period of time there should be planned travels to the delegating office in order to undertake discussions about the future position and final appraisal interviews[54].

Expatriate care and supervision - This measure aims to help the employee to keep in touch with the delegating organization during his stay abroad in order to facilitate his reintegration process. It should cover support by the delegating office, in particular by the Human Resources department and a supervisor who will act as a mentor[55]. Keeping the expatriate updated about changes such as staff turnover, organizational restructuring and technical innovations have crucial importance for

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[52]Personal Manager 2014, p. 109: http://www.datakontext.com/download/Personal_Manager_1-2013/page7.html#/0 (online 2015).
[53]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp. 339-350, 2011.
[54]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 58, 2012.
[55]See DGFP e.V., Expat-Management – Auslandseinsätze erfolgreich gestalten, vol. 2, Bielefeld, pp. 145-156, 2010.

his return. Moreover, there should be organized regular travels to the delegating office in the home country in order to support the employee to stay part of his social network[56]. In addition, each expatriate should be supported by a mentor who provides psychological care for the employee. An ideal mentor should be a more senior and internationally experienced colleague within the same functional area. The mentor assumes the role of a contact person in case of questions or issues and represents the expatriate's interests in the delegating office. Especially in the context of a future position, the role of a mentor is crucial, as he is able to inform the expatriate about vacant positions and communicate his expectations towards the new job after the assignment has terminated[57].

Professional development - While it has been proved that the performance of expatriates rises during assignments, in some cases it can even decrease after the employee has returned. Therefore, it is very important to support the growth of performance not only during the stay abroad but also during the reintegration process. Constant development opportunities and the definition of an appropriate future position are the main measures to prevent potential risks within the professional reintegration process. Due to the connection between present aimed advancement of employees and the employees' satisfaction during the reintegration phase, the professional development plays an important role for financial organizations to achieve established goals. The prospect of promotion motivates expatriates to contribute positive performance during and after the assignment. Finding a future position, which matches the abroad gained skills, knowledge and expectations of an employee will also provide benefits towards the contributed investment of an organization to send him abroad[58].

Another important measure refers to compensation arrangements. In the

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[56]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp.339-350, 2011.

[57]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 42-43, 2012.

[58]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (available online, 2015).

context of international remuneration policy, compensation during assignments should prevent financial disadvantages for expatriates and at the same time provide sufficient incentive to take over the job abroad[59]. Remuneration packages vary depending on the compensation levels and living standards in the target country. However, in most cases expatriates receive higher salaries due to additional benefits and equalization payments. Therefore, it is crucial for financial organizations to design fair and transparent remuneration packages during the whole assignment. On one hand, this should help financial organizations to demonstrate which parts of the salary refer to assignment-related benefit payments while, on the other hand, the employee should be prepared for potential reductions of these benefits after the return. Imaginary reference salary calculations during an assignment can be helpful to define an appropriate compensation upon the return to the delegating office[60].

Reintegration workshops - They imply psychological supportive measures, which aim to facilitate the readapting process for expatriates and potential family members. It is intended to counteract possible issues within the professional and social environment of repatriates by pointing out where these can arise. Thereby, it is aimed to achieve positive attitudes and behaviour towards the reintegration process. Moreover, reintegration workshops provide repatriates the possibility to exchange views and reflect their experiences with other former expatriates[61].

Employee loyalty and feedback discussions - This measure aims to prevent the risk of staff fluctuation in order to retain qualified employees long-term. In the context of Expatriate Management, dissatisfaction during the assignment and especially return phase can bear the risk of losing employees. A fully benefit from the whole assignment is only given if the employee stays within the delegating office

[59]See FESTING, DOWLING, WEBER, ENGLE, ALLEN, *Internationales Personalmanagement*, vol. 3, Wiesbaden, pp. 339-350, 2011.
[60]Personal Manager 2014, p. 109: http://www.datakontext.com/download/Personal_Manager_1-2013/page7.html#/0 (available online, 2015).
[61]Institut für Interkulturelles Management: http://www.ifim.de/foliensets/reentry/reentry.pdf (online, 2015).

after his return. In the light of employee loyalty, feedback discussions play a crucial role for a successful reintegration. They aim to recognize where there is still the possibility for improvement and show existing deficits within the current assignment policy. Moreover, feedback discussions indicate consideration of the employee's point of view and allow him to communicate pending issues during the re-entry[62].

7. While multiple researches have shown the great influence of preventive measures on the success of assignments and their reintegration process, most of companies do not yet apply to them in practice. Considering the fact that failure rates for overseas assignments average 45 percent, employers should understand how to best support expatriates. Following are specific ways HR professionals can strengthen expatriate programs and policies:

Appoint a replacement facility in the host country. A replacement service can make the difference between productive employees able to focus on challenges at work, and distracted and frustrated individuals who feel the company has deserted them. One expatriate's employer refused to hire a replacement facility, instead asking its local corporate attorney to negotiate the real estate lease and obtain the residency permits. Because the attorney had to educate himself in these areas, the company spent three times what it would have spent for a relocation service offering more competent and comprehensive assistance. Services provided can include obtaining immigration and work permits, car and home insurance, and drivers' licenses; locating housing; negotiating leases; facilitating connection of residential utilities; finding doctors and sorting out health care issues; selecting schools; and helping clients assimilate into the new culture.

Provide predeparture assistance and ongoing consultation for expatriates and their families. Expatriates rarely receive any predeparture assistance beyond

[62]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (available online, 2015).

tax advice and relocation of household goods. It is crucial that, at the very least, basic language skills and cross-cultural training be provided. Predeparture assistance should also address critical family issues such as what the partner will do children's schools, medical coverage, and making friends. In addition, basic household issues such as temporary living accommodations, obtaining appliances compatible with foreign electric service, banking needs, and shipment logistics should be addressed. The most successful expatriate families develop action plans for the first two weeks, one-month, three months and nine months, with key milestones they are striving to achieve. It is important do not assume that no news is good news, but maintain regular contact with expatriates. Become a trusted resource for resolving issues at headquarters and lend a sympathetic and confidential ear when expatriates just need to vent. I suggest calling weekly during the first 60 days of expatriation and monthly thereafter for the first year.

Design flexible expatriate policies. Instead of allowances and premiums governed by arbitrary rules, provide a fair budget and a choice of support services. That approach spends employers' money more wisely and gives expatriates the sense that the company understands the challenges their families will face.

Monitor internal systems and people. It is important to make sure that an organization is not so headquarters centric. Can the accounting staff translate foreign currency? Are phone conferences scheduled with faraway time zones in mind? Do procedures accommodate entirely different systems overseas? Financial organizations operating overseas need to invest in global awareness training and education for employees at all levels in the organization who are involved with global operations. This modest expenditure will result in a much greater return in all the investments being made in the firm's global expansion.

Solve quickly the difficult issues. Can be very important to help employees to focus on the difficult problems of integrating expatriates and their families into their host country—not just the "easy" issues of moving households and managing tax implications. Recognize the differences between expatriates, then use that recognition as a departure point for developing expatriate policies. The cost-benefit ratio of serving a small pool of expatriates may seem high, but the company's investment in expatriates may be the key to future business success. Enhanced support from HR reduces the risks of the financial organizations' expansion strategy and enhances the chances of success.

Taking in account the survey by PwC and the Cranfield School of Management, only two out of nine enterprises have formalized reintegration policies, which support repatriates upon their return to the delegating office.[63] However, according to the current status of research, 60 per cent of all repatriates struggle with issues during their reintegration phase. In 25 per cent of the cases, they are even terminations on part of the repatriate during this time.[64] Furthermore, most of financial organizations focus mainly on the recruitment of suitable assignment candidates[65] rather than on their reintegration.[66] In addition, the timely framework still shows deficits as the planning of reintegration starts later than recommended in scientific findings[67]. In spite of the obvious added value of reintegration workshops, they still are rarely offered by financial organizations. Most enterprises do not consider them to be necessary for expatriates who are sent abroad within Europe and USA. Moreover, they mention financial reasons or no need on part of the expats[68]. When it comes to the participation of mentors during an assignment, a survey carried out by Burghaus A. has shown positive results from the organiza-

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[63]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (available online, 2015).

[64]See HOFMANN, ROHRBACH, *Internationaler Mitarbeitereinsatz. Gestaltungsalternativen-Praxisfälle-Prüfschemata*, vol. 3, Münster, pp. 81-84, 2011.

[65]See CASALINO, *Learning to Connect: a Training Model for Public Sector on Advanced E-Government Services and Inter-Organizational Cooperation*, in *International Journal of Advanced Corporate Learning (iJAC)*, Austria, vol. 7, no.1, pp. 24-31, 2014.

[66]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (available online, 2015).

[67]See HOFMANN, ROHRBACH, *Internationaler Mitarbeitereinsatz. Gestaltungsalternativen-Praxisfälle-Prüfschema*, vol. 3, Münster, pp. 81-84, 2011.

[68]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, pp. 67-68, 2012.

tional point of view[69]. According to the survey, 41 per cent of all interviewed companies provide an adequate mentor within the delegating office while 47 per cent provide one mentor in the home country and another one abroad[70].

The survey on reintegration within Expatriate Management carried out by PwC and the Cranfield School of Management has shown that the rate of ongoing employment of repatriates is lower than of general employees. However, this changes after the first two years after the return. Against this background, it is clear that the achievement of positive employee loyalty plays an important measure for a successful reintegration, especially in the first two years after the return[71].

Long-term expatriation is usually negotiated for a period of one year to three years, sometimes even longer. Expatriate leaves abroad with his/her family in this case. Moreover, the social and economic background is more complex and wider in this form of leaving. This also counts with suitable educational facilities for their children. A form of so-called virtual expatriation may be used in a case of some reluctance and fear of a long-term stay and if it is allowed by practical circumstances. For the reasons mentioned above, it is very difficult to decide whether it is needed to send expatriates or it is sufficient to use the local managers of the host country for meeting corporate strategic objectives. It is influenced by many factors. It is especially recommended to use expatriates in less developed countries, where there is a shortage of skilled workers with sufficient managerial skills. Or it is also recommended in a case of building or establishment of an entirely new foreign branch, when this "event" cannot be handled without expatri-

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[69]See CASALINO, ARMENIA, DRAOLI, *A System Dynamics model to identify and measure the paper digitization advantages in Public Administration, in Achieving Fusion in the Interconnected World: Exploring the Connection Between Organizations and Technology*, D'Atri A., De Marco M., Braccini A.M., Cabiddu F. (Eds.), ItAIS, Physica-Verlag, Springer, Heidelberg, Germany, pp. 29-36, 2010.

[70]See BURGHAUS, *Auslandeinsatz von Mitarbeitern: Maßnahmen zur erfolgreichen Reintegration von Mitarbeitern*, Saarbrücken, p. 42, 2012.

[71]http://www.pwc.ch/user_content/editor/files/publ_tls/pwc_mehrwert_int_mitarbeitereinsaetze_d.pdf (online, 2015).

ates.

As it has been already mentioned, employment of expatriates is much more expensive than hiring local people for the company. The high cost of expatriates lies primarily in the need for a compensation of disadvantages such as complications of traveling and living outside their own socio-cultural environment. As Armstrong (2006) states, expatriates are expensive. They can become three or four times more expensive than employment of the same people in the company. It is difficult to manage expatriates due to problems associated with the adaptation to the unfamiliar surroundings and working in it because of worries about their development and career problems emerging after their return to the parent company, etc.

Advantages of expatriates' engagement can be primarily seen in their high-quality professional, managerial and diplomatic skills in a host country, likewise in knowledge of the overall organizational culture and structure of the company. On the other hand, to hire local managers on management positions leads to lower labour costs, good knowledge of culture and social environment of the host country, knowledge of municipal and government policies, lower administrative burden of employment and the formation of a favourable relationship between local population.

8. A successful reintegration is the key to a sustainable benefit from an assignment, both for the employee and the organization, with regard to the gained experiences for an expatriate and the financial investment made by an enterprise. However, assignments may differ due to a wide number of factors ranging from the target country, the grade of cultural differences, personal ability to adapt to foreign cultures and new circumstances to the willingness to return home, the job level and family circumstances. There are varieties of cultural considerations for the expatriate going to other foreign countries. Expect culture shock to occur after the initial excitement of being in a foreign place to occur. The expatriate may en-

counter racial stereotypes that can exacerbate feelings of culture shock. It is natural for a person in unfamiliar surroundings to seek something of the familiar. Expatriates may find support from other expatriates who are in similar situations. It would be much more conducive to the expatriate's personal and professional development if he/she can seek out other expatriates who will act as a mentor to assist in the integration to the host country instead of those who reinforces negative views of the local culture. There are no finalized preventive measures that match to every single person and organization. Nevertheless, it is essential to ensure a transparent process and open communication during the whole assignment to convey expatriates the impression that they and their commitment contribute a significant value to the company. Contrary to popular beliefs of organisations, women expatriates can become successful. Moreover, women can and do succeed in patriarchal countries, locals do not accord the same limitation to women expatriates as they do to local women. Women expatriates have skills and knowledge that organisations have not previously identified as valuable that allows them to be successful in such countries.

The results of the research have confirmed that the application of preventive reintegration measures can have very positive effects on the employer's satisfaction, performance and loyalty towards the organization after an assignment.

The cultural roles of men and women should be included in female expatriate training. They should receive information on the appropriate and inappropriate behaviours of men and women, as well as various policies and procedures regarding laws of sexual harassment. There are some limitations to sending an expatriate female as the field of women expatriates are quite new. These limitations however need to be address as trends are changing and a lot more women are being sent overseas. Human resource policies and procedures need to be re-evaluated to meet this future trend.

In conclusion, this topic allowed us to explore some of the main problems that it is possible to encounter when people become expatriates on an international assignment in other countries. It is fundamental to overcome assumptions to make the international assignment a success. The described risks during the return phase for give reason to attach greater importance to the use of preventive reintegration measures in terms of an overall successful assignment.

RECENT TRENDS IN DESIGNING THE EU ANTI-MONEY LAUNDERING REGULATORY LANDSCAPE: THE FOURTH AML DIRECTIVE BETWEEN LIGHTS, SHADOWS AND FUTURE PERSPECTIVES

Alberto Urbani [**] - Andrea Minto [***]

ABSTRACT: *Money laundering and terrorist financing are lately becoming high a priority on EU policy- makers' agenda as never before. This paper examines how the European Anti-Money Laundering (AML) regulatory landscape is evolving in its design, contents and purposes. In doing so, it touches upon the major innovations brought in by the Forth Anti-Money Laundering Directive and by the recent EC amending Proposal.*

On one hand, issues relating to customer due diligence and beneficial ownership are dealt with. On the other hand, perils attached to the greater prominence gained by tax crimes are pointed out, bringing to the fore the question of whether the original AML goals are possibly overcome by the prevention of tax evasion. In providing a way forward, the paper finally provides insights on the challenges of the current AML supervisory framework.

SUMMARY: 1. The link between Directive 2015/849/EU (along with the recent amending Proposal) and the previous Anti-Money Laundering Directives: the steps forward made by the Fourth Directive. – 2. "New types" of money laundering and terrorist financing activities and consequent problems for the national and supranational legal systems. – 3. The amendments regarding the customer due dili-

[**] Associate Professor of Banking law at Ca' Foscari University of Venice, Department of Economics, albeurba@unive.it

[***] Assistant Professor in Economic Law at Utrecht Law School - Utrecht University, Faculty of Law, Economics and Governance, A.Minto@uu.nl

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gence procedures. – 4. Old and new issues relating to «*beneficial ownership*». – 5. The setting up of national central registers to enhance the beneficial ownership identification. – 6. Countering money laundering and terrorist financing in the era of the Single Supervisory Mechanism.

1. According to the original plans of the European Union, by 26 June 2017 the Member States were supposed to implement, in their national legislation, Directive 2015/849/EU (hereinafter, also referred to as “Fourth Directive”) concerning the prevention of the use of the financial system for the purposes of money laundering or terrorist financing. The recent dramatic upsurge in terrorist attacks however has been a “wake-up call” for EU policy-makers to promptly go back over such plans and revise the anti-money laundering (AML) legislation. Not only did EU policy-makers push ahead the deadline to implement the new European AML rules by the Member States, but they also set up additional complementary measures aimed at effectively countering the funding of any terrorist organization or initiative. Thus, on one hand, the European Commission encouraged the Member States to do their best to transpose beforehand the Fourth Directive, namely by 1st January 2017. On the other, the European Council conclusions[1], where EU leaders called for a stronger coordinated European response to combatting terrorism, and the comprehensive Action Plan to strengthen the fight against the financing of terrorism presented by the European Commission the 2nd February 2016[2], sparked off the legislative process to amend the “still to be implemented” Fourth AML Directive.

All these efforts led eventually the Commission to present on the 6th July 2016 the «*Proposal for a Directive of the European Parliament and of the Council amending Directive 2015/849/EU on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive*

[1] See European Council, 17-18 December 2015 – Conclusions, available at http://www.consilium.europa.eu/en/press/press-releases/2015/12/18-euco-conclusions/

[2] See European Commission, *Communication from the Commission to the European Parliament and the Council on an Action Plan for strengthening the fight against terrorist financing*, COM (2016) 50 final.

2009/101/EC»[3] (hereinafter mainly referred to as amending Proposal), which is optimistically supposed to be adopted in time to let the Member State implement it together with the previous one.

As mentioned before, Directive 2015/849/EU is, and is often referred to as, the Fourth Directive on anti-money laundering. The First AML Directive, Directive 91/308/EEC, was remarkably inspired by the Italian legislation which was entering into force in those same years[4]. Despite dating back to 1991, it contained all the essential features the current regulatory architecture is still based upon. The Second AML Directive, Directive 2001/97/EC, extended the application of many of the anti-money laundering requirements, at first only designed for banks and financial intermediaries in general, to other categories of traders concerned with the production or sale of goods of high economic value, as well as to the so-called legal and accounting professionals. Finally, the Third Directive, Directive 2005/60/EC (later supplemented by Directive 2006/70/EC), added more detailed rules concerning the identification of customers by setting up diversified customers due diligence obligations depending on the estimated degree of risk of money laundering or terrorism financing[5].

Coming to present days, the Fourth Directive does not reverse the steady trend in designing the EU anti-money laundering regulatory landscape and, most certainly, does not mark a legislative overhaul: once again, the European Union has wisely chosen to intervene gradually over time without disrupting the original set of pillars and principles the anti-money laundering legislation (hereinafter AML legislation) has been built upon ever since the First Directive has been enacted. In other words, the AML legislation has always been amended by virtue of a “normal mainte-

[3]European Commission, COM (2016) 450 final.

[4] Thanks also to the dedication and visionary experience of the judge Giovanni Falcone, rightly considered by many the putative father, at least, of the Italian law 5 July 1991, n. 197, the first Italian piece of legislation on the matter.

[5] For a summary of the AML legislative evolution, see, i.e., ERLIN-KARNELL, RYDER, *The Robustness of EU Financial Crimes Legislation: A Critical Review of the EU and UK Anti-Fraud and Money Laundering Scheme* (May 2016), in *European Business Law Review*, 2017, Forthcoming, available at http://ssrn.com/abstract=2816980; VAN DER BROEK, *Preventing money laundering: A legal study on the effectiveness of supervision in the European Union*, Eleven Publishing, 2015, p. 17 ff.

nance" approach, being constantly updated on the experience gained in applying and enforcing the rules and on the predictable evolution of the phenomena these same rules have to cope with.

The Fourth Directive, which should be implemented and come into force in the national jurisdictions by 26th June 2017 (or by 1st January 2017, according to the stricter timeline the Commission is wishing for), aims in particular to implement the recommendations of the Financial Action Task Force (hereinafter FATF) issued in February 2012[6], without any change whatsoever to the foundations of the regulatory architecture, which remain firmly entrenched in the two essential pillars of the customer due diligence and the reporting obligation[7].

At its simplest, the wider notion of "money laundering" and the greater obligations relating to the customer due diligence are the most significant new developments brought in by the Fourth Directive. The very notion of "money laundering" now expressly covers tax crimes among the possible predicate offences to money

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[6]See FATF-GAFI, *International standards on combating money laundering and the financing of terrorism & proliferation*, February 2012, available at *http://www.fatfgafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf*. Such standards have been recently updated at the beginning of 2016. For a very first comment, see, i.e., BALDASSARRE ed GARA - PAVESI in *Profili internazionali dell'attività di prevenzione e contrasto del riciclaggio di capitali illeciti*, in Condemi e De Pasquale (eds.), Roma, 2004, p. 302 ff.; GILMORE, *Dirty Money: the evolution of international measures to counter money laundering and the financing of terrorism*[4], Council of Europe Publishing, 2011, p. 15-21; KAETZLE, KORDYS, F*ourth Money Laundering Directive: increased risk management requirements*, *Compliance & Risk*, 2015, 4(5), p. 2 ff.

[7]In that regard, it is worth noting that unlike some AML national legislation such as the Italian one (see art. 36 ff. Legislative Decree no. 21 November 2007, n. 231), the European AML legislation does not impose any obligation to record customer data and high value transactions, but it only requires to keep copies of the documents used for identification (now, art. 40 of Directive 2015/849/EU); similarly as regard the restrictions on the use of cash and (at least in part: see. In fact, the art. 10 of Directive 2015/849/EU) on bearer documents (art. 49 of the D. lgs. n. 231/2007 cit.). However, it must be pointed out that among the most significant innovations that the Proposal for amending Directive might bring in, there is also the setting up of centralised automated mechanisms, such as a register or data retrieval system in all Member States as an efficient means to get timely access to information on the identity holders of bank and payment accounts, their proxy holders, and their beneficial owners (see recital 15 and 16 and the proposed amended art. 32-*bis* of the Fourth Directive).

As far as reporting a money laundering transaction is concerned, the Proposal might bring about a useful integration of art. 32 of the Fourth Directive, according to which the Financial Intelligence Units of the Member States would be authorized to obtain information, to anti-money laundering or terrorist financing purposes, by any obliged entity even in the absence of any suspicious transaction reports.

laundering, and, on the other hand, the extension of the customer due diligence obligations aims at better identifying the beneficial owners of the monitored transactions. On a higher altitude, the new Directive prompts some considerations relating to the matter of supervision, especially in light of the new European architecture centred on the Single Supervisory Mechanism (SSM).

The next paragraphs will touch upon some critical issues stemming from the Fourth Directive. Far from being a comprehensive and thorough review of the new legislation, in fact, the analysis will be confined to some specific features of the directive in order to highlight strengths and weaknesses put in the general context of the AML legislation. Such selection of issues is supposed to shed some lights on potential perils attached to recent trends in regulating money laundering. Far from providing the last say, this article aims at opening up new avenues for further research in the field. At the same time, the recent amending Proposal will be taken into consideration whenever it could produce any relevant effects on the matters to be dealt with.

2. As aforementioned, the inclusion of tax crimes as predicate offences to money laundering is one of the main changes regarding the material scope of the AML legislation. However, the notion of money laundering itself has not been touched. Art. 1, par. 3, let. *a)*, Directive 2015/849/EU qualifies within the conducts, if committed intentionally, which shall be regarded as money laundering (and so did the Third Directive already) «*the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an activity to evade the legal consequences of that person's action*»; likewise, the following letters of par. 3 refer to other conducts, for instance, (let. b) to «*the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property*», but always these conducts being based on a «*criminal activity*»

committed beforehand[8].

Thus, to catch the innovative character of the Fourth Directive in that respect, the definition of "criminal activity" should be looked at. Indeed, art. 3, par. 4, in fleshing out such concept of criminal activity, now explicitly states at let. f) «*all offences,* including tax crimes *relating to direct taxes and indirect taxes and as defined in the national law of the Member States, which are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as regards Member States that have a minimum threshold for offences in their legal system, all offences punishable by deprivation of liberty or a detention order for a minimum of more than six months*».

It might be argued, however, that the newly-introduced explicit reference to tax offenses does not make any real substantial change. The Third Directive in fact defined predicate offences to money laundering all «*serious crimes*» generically (see art. 3, par. 4 and 5, Directive 2005/60/CE) and, being the «*tax crimes*» obviously a subset of «*crimes*», they were already implicitly potential predicate offences, once qualified as being serious crimes[9]. There is no reason to believe that serious tax crimes could have escaped the wide net cast by the Third AML Directive. Naming overtly tax crimes within the predicate offences therefore ends up rather in recognizing a substantial overhaul of AML legislation goals, which were originally targeted at countering the re-use of money or other benefits generated by specific offenses and now increasingly oriented to the prevention and prosecution of tax evasion as such[10]. In that respect, the same European Commission acknowledged that tax crimes

[8]On the notion of «*money laundering*» see, i.e., VAN DEN BROEK, cit., p. 4; FERWERDA, *Definitions of money laundering in practice*, in *The economic and legal effectiveness of the European Union's anti-money laundering policy*, UNGER, FERWERDA, VAN DEN BROEK, deleanu (eds.), Cheltenham, UK, Edward Elgar, 2014, p. 87 ff.

[9]Quite instructive on this matter, for example, in the ambit of the Italian legislation the *Istruzioni operative per la segnalazione di operazioni sospette* issued by BANCA D'ITALIA, provv. 12 January 2001, Introduzione, par. 1 and Parte seconda, Introduzione alla casistica; see also BORLINI, *Issues of the International Criminal Regulation of Money Laundering in the Context of Economic Globalization*, Paolo Baffi Centre Research, Paper No. 2008-34.

[10]Such tendency has been pointed out already by BURRELL, *Preventing Tax Evasion through Money Laundering Legislation*, *Journal of Money Laundering Control*, 2000, Vol. 3 (I), p. 304 ff.;

are brought within the scope of the powers and authorities used to combat money laundering in order to contribute to better coordination between AML and Tax authorities, and to remove potential obstacles to international cooperation regarding tax crimes[11].

The objective is clear, and quite acceptable. Not only is tax evasion high a priority of policy makers' agenda, and even more so for Member States over EU itself, but tax misconduct determines first and foremost negative effects for the community, distortions of competition to the detriment of economic operators, altering the proper market dynamics[12]. Apart from the sanctions for the violations of the AML rules, such a policy begs the question of whether and how, at least in cultural contexts where tax evasion is less socially disqualifying than elsewhere, this extension may end up "watering down" the sensitivity and cooperation of operators and intermediaries, for example by getting them to consider less rigorously and carefully any suspicion of money laundering coming from evasion compared to those generated by crimes that are of greatest social impact or connected to terrorist intents.

As the recital 11 of Directive 2015/849/EU acknowledges, a main reason of concern is that criminal tax law is up until now far from being harmonised among the Member States, with the result that the very notion of money laundering can have a greater or lesser extent depending on whether or not, in that particular country, a certain tax behaviour qualifies as a criminal offense[13]. With regard to possible money-

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MARIANO-FLORENTINO, *The Tenuous Relationship between the Fight Against Money Laundering and the Disruption of Criminal Finance*, *Journal of Criminal Law and Criminology*, 2003, Vol. 93, p. 311 ff.; more recently, TAVARES, *Relationship between Money Laundering, Tax Evasion and Tax Havens*, Special Committee on Organised Crime, Corruption and Money Laundering (CRIM), Thematic Paper on Money Laundering, 2013.

[11]See European Commission, *MEMO. Frequently asked questions: Anti-Money Laundering, Brussels*, 5 February 2013, available at *http://europa.eu/rapid/press-release_MEMO-13-64_en. htm?locale=en*.

[12]INTERNATIONAL MONETARY FUND, *Financial System Abuse*, *Financial Crime and Money Laundering—Background Paper*, 2001; G.W. SMITH, *Competition in the European Financial Services Industry: The Free Movement of Capital Versus Regulation of Money Laundering*, in *University of Pennsylvania Journal of International Business Law*, 1993, n. 3, p. 101 ff.

[13]Consequently, the recent amendment proposal specifies, at art. 57, that «*Differences between national law definitions of tax crimes shall not impede the ability of FIUs to provide assistance to another FIU and shall not limit the exchange, dissemination and the use of information pursuant to Articles 53, 54 and 55*».

laundering operations carried out in countries other than those in which, in theory, has been committed the tax offense, it is clear, at least, the difficulty for the subjects called to identify any suspicious transactions to discern between fiscally lawful and unlawful behaviours, since these individuals are hardly in possession of such a level of expertise in tax matters.

On a different note, the brief reference above to the countering of terrorist financing provides the opportunity to highlight how the new AML legislation sees this objective as a complement to effectively cope with the more "traditional" money laundering phenomenon.

No legislative amendments have been made in this respect. In line with the Third Directive, in fact, article 1, par. 5 of the Fourth Directive, keeps defining "terrorist financing" by mentioning the offenses referred to in articles from 1 to 4 of the Council Framework Decision 2002/475/JHA on combatting terrorism. However, the recent attacks that have bloodied the French soil cannot pass by unnoticed: first the attack in Nice during Bastille Day festivities and only a few days later, the priest killed during morning Mass at the historic church in a suburb of Rouen; almost simultaneously – and just to stay in Europe – in Germany some passengers were attacked with an axe on a commuter train. Events such as those just mentioned (and many others fortunately foiled preventively) show clearly how terrorist strategies, especially those of jihadist strand, are rapidly changing their underlying connotations. In fact, not only did they result in the occupation of vast territories (the so-called well-known "Islamic State", or "Caliphate") they also lately took the shape of individual, autonomous or small informal groups initiatives. These new phenomena called upon the countries victims of such events to set up the most appropriate tools, in both a preventive and repressive fashion.

Therefore, the abovementioned decision of the Council seems to still fit the purpose since the two definitions of «*terrorist offenses*» (art. 1) and «*offenses relating to a terrorist group*» (art. 2) were already framed and phrased, in 2002, as wide as to capture each and every heterogeneous manifestation of terrorism, in a forward-looking fashion[14]. On the sheer regulatory side, therefore, the systematic review of the alerts or anomaly indicators for suspicious transactions which are not imposed and even mentioned in the directive but that are set out by the competent supervisory authorities in many Member States (sometimes even in the form of mere red flags or warning criteria), is to be definitely seen favourably in the light, for example, of the risk-based approach (see recital 22) and of the comprehensive regulatory powers the supervisors are entrusted with (see, in particular art. 8, and the rules contained in Chapter VI of the Fourth Directive). But even apart from that, it is evident that greater attention by operators called upon to timely discern any possible symptom of behaviours potentially finalized to finance terrorist activities – even if modest, given the most recent actions were organised – can be a useful bulwark in combatting such a dangerous and deplorable phenomenon.

The concept of terrorist activity presupposed by the AML legislation, on the other hand, is obviously far from being perfect in contrasting all new possible ways of terrorist financing and requires a never-ending fine-tuning process. Speaking of which, in fact, the mentioned amending Proposal by the Commission to develop and enhance the Fourth Directive builds upon the awareness of such a problem, and, from the very beginning it emphasizes that «*Recent terrorist attacks have brought to light emerging new trends, in particular regarding the way terrorist groups finance and conduct their operations. Certain modern technology services are becoming more and more popular as alternative financial systems and remain outside the scope of Union legislation or benefit from exemptions that may no longer be justified. In order to keep pace with evolving trends, further measures to improve the existing preventive framework should be taken*» literally, recital 2, but see, along with it, recital 6

[14]For the purposes of the Fourth AML Directive, «terrorist financing» means the provision or collection of funds, by any means, directly or indirectly, with the intention that they be used or in the knowledge that they are to be used, in full or in part, in order to carry out any of the offences within the meaning of articles 1 to 4 of Council Framework Decision 2002/475/JHA (see art. 1, co. 5, Directive 2015/849/EU). On the notion of terrorism enshrined in the AML legislation see DURRIEU, *Rethinking Money Laundering & Financing of Terrorism in International Law*, 2013, Martinus Nijhoff Publisher, Leiden, p. 118.

with specific reference to the use of new virtual currencies and recital 11 and 12 in relation to the use of prepaid cards).

Hence the appropriate decision[15] to extend the AML obligations to «*providers engaged primarily and professionally in exchange services between virtual currencies*[16] *and fiat currencies*» and to «*wallet providers offering custodial services of credentials necessary to access virtual currencies*». Besides, the Member States should make the taking-up of such activities and businesses subject to or, at least, registration[17], and, the tightening of rules on the use of prepaid cards (for example, by forbidding online transactions for anonymous cards), even more so if issued in third countries. In fact, despite the undeniable advantages and promising opportunities for the development of trade, the increased success and use of Bitcoin and prepaid cards raises new perils relating to money laundering and terrorist financing. Indeed, such payment instruments can serve the purpose, better than more traditional ones, of effectively subsidizing international terrorist networks or, simply, of paying certain logistical aspects related to criminal activities, especially by means of the high degree of anonymity that they offer over traditional tools for the transfer of funds. Against this backdrop[18], EU and national policy-makers were called upon to fill the gaps of the AML legislation.

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[15]The EUROPEAN BANKING AUTHORITY welcomes the Commission's Proposal in its *Opinion […] on the EU Commission's proposal to bring Virtual Currencies into the scope of Directive 2015/849/EU (4AMLD)*, 11 August 2016 available on the institutional website.

[16]According to the amending Proposal, «"*virtual currencies" means a digital representation of value that is neither issued by a central bank or a public authority, nor necessarily attached to a fiat currency, but is accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically*».

[17]This would amount to something less than a real authorization: a kind of mere "supervision on the registry office", in some ways along the lines of what, until the reform of 2010, in Italy characterized the intermediaries of the general register set out by art. 106 of the Banking Law (Legislative Decree 1 September 1993, n. 385).

[18]Regarding the money laundering and terrorist financing risks attached to the "virtual currencies" (*bitcoin*), see, i.e., OGUNBADEWA, *The Virtues and Risks Inherent in the 'Bitcoin' Virtual Currency*, University of Wales System – Cardiff Law School, 2014; BRYANS, *Bitcoin and Money Laundering: Mining for an Effective Solution*, in *Indiana Law Journal*, vol. 89, 2014, p. 441 ff.; BÖHEME, CHRISTIN, EDELMAN, MOORE, *Bitcoin: Economics, Technology and Governance*, in *Journal of Economic Perspectives*, vol. 29, n. 2, spring 2015, p. 213 ff.

3. The customer due diligence obligations is the second major area where innovations were brought in by Directive 2015/849/EU. In that respect, the changes are driven by a twofold objective, inspired by the increasing belief, at the EU institutions, that the Third Directive were overly permissive on that requirement[19].

Thus, on one hand, there is a crackdown on the conditions under which the customer due diligence has to be carried out. The innovations, on this side, concern neither the case of establishing a business relationship or the occasional transaction (whether the transaction is carried out in a single operation or in several operations which appear to be linked)[20], nor the cases of suspicion of money laundering or terrorist financing, nor the ones regarding the doubts about the veracity or adequacy of previously obtained customer identification data: all these cases have already been included in the previous directive still in force.

The tightening of controls rather comes from the introduction of the customer due diligence measures in the following three new circumstances: i) the electronic transfer of funds, as defined in point (9) of art. 3 of Regulation 2015/847/EU of the European Parliament and of the Council, exceeding EUR 1.000; in the case of persons trading in goods, when carrying out occasional transactions in cash amounting to EUR 10.000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked; lastly, for providers of gambling services, upon the collection of winnings, the wagering of a stake, or both, when carrying out transactions amounting to EUR 2.000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked. This is, quite obviously and as the same experience shows, the easiest way to move wealth for illegal purposes and that in the case of electronic funds transfer (and likewise if gambling takes place via the internet) can moreover take advantage of the speed and by the

[19]See in particular the *Commission Staff Working Document impact assessment*, accompanying the amending Proposal as regard the simplified customer due diligence measures, which are considered «*overly permissive*» (III.4.2, box 6).

[20]For transactions of not less than 15.000 EURO (however with some important exceptions, related primarily to those who operate on an occasional or very limited basis, as enshrined in art. 2, par. 3 and 4).

more opaque character of computer and data channels[21].

Consequently, differentiated thresholds depending on the type of operation concerned and the degree of risk that the EU legislation attaches to it are set out. However, this was already the case in some Member States by application of the rule – reaffirmed in art. 5 of the new directive – which allows the national jurisdiction to impose stricter requirements than the European ones. Because such differentiation is by subjects, there is no risk that the person/subject to whom that requirement applies does not recall easily the threshold relating to their specific activity. Such risk is instead real in national legislation, like the Italian one, where, according to its AML rules, different limitations apply depending on whether you transfer money by using cash, check or a bank or postal saving book bearer[22].

The Fourth AML Directive, in line with the previous directive as well as with the banking supervision methodology, is structured and implemented according to the risk-based approach[23].

In fact, the Third Directive, once having laid down the general rules for customer due diligence obligations, provided for the «*simplified customer due diligence*» (art. 11-12), first, and the «*enhanced customer due diligence*» (art. 13), then, precisely depending on the level of risk of the transaction or operation presumed by the lawmaker. The Fourth Directive, despite confirming such a distinction, treats differently

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[21]See recital 19 of the Fourth AML Directive. Within the academic literature, see already POMANTE, Internet *e criminalità*, Torino, 1999; URBANI, *Disciplina antiriciclaggio e ordinamento del credito*, Padova, 2005, p. 39 ff.; LEVI, *E-gaming, money laundering and the problem of risk assessment*, in *Research Handbook on Money Laundering*, UNGER, VAN DER LINDE (eds.), Edward Elgar, Cheltenham, 2013, p. 332 ff.; CHONG, LOPEZ-DE-SILANES, *Money Laundering and its Regulation*, *IDB Working Paper*, 2007, No. 493; CHAIKIN, *Risk-Based Approaches to Combating Financial Crime*, *Journal of Law and Financial Management*, 2009, Vol. 8, No. 2, p. 20-27. It is quite evident these reasons are the same the amendment Proposal puts forward regarding the virtual currencies, aforementioned in the previous paragraph.

[22]See VERHAGE, *Global governance = global compliance? The uneven playing field in anti-money laundering*, in *The Routledge Handbook of White-Collar and Corporate Crime in Europe*, in VAN ERP, HUISMAN, VANDE WALLE (eds.), 2015, p. 479.

[23]See PISANI, *L'adeguata verifica e l'approccio basato sul rischio nella disciplina antiriciclaggio*, in *Il fisco*, 2012, 1, p. 1151; DALLAPELLEGRINA, MASCIANDARO, *The Risk Based Approach in the New European Anti-Money Laundering Legislation: A Law and Economics View, Paolo Baffi Centre Research Paper No. 2008-22*.

the “simplified” and “enhanced” obligations. For the latter, the changes brought in by the new directive are not particularly relevant (except for the extension of the “enhanced” obligations to cases of involvement of «*politically exposed persons*» residing in the same member State of the obliged entity/subject required to carry out the due diligence, whereas previously it was confined to politically exposed persons residing in another member State or in a third country[24]). For the former, unlike the third directive, there is no precise indication of the circumstances under which the simplified customer due diligence must be applied (for example, if the counterparty of the transaction or operation was a credit or financial institution bound by the same or at least similar AML obligations). Thus, the Fourth Directive makes the Member States or the same obliged entity responsible for identifying areas of lower risk of money laundering or terrorist financing rather than making that assessment itself. At least in the intention of the legislator, such a change is not to be interpreted as making Member States or the obliged entity completely free to adopt simplified customer due diligences measures. Indeed, the presumable discretion enjoyed by the Member States or the obliged entity is actually confined by a detailed list of criteria collected in the Annex II of the Directive, and, by the sanctions measures that might be imposed either to the Member States or the obliged entity.

4. The criteria for determining the so-called «*beneficial owner*» of the transaction or operation is the second major area of innovation regarding the customer due diligence.

As well known[25], the customer due diligence is to be performed not so much

[24]See, comparatively, art. 13, par. 4, Directive n. 2005/60/CE and art. 20 Directive n. 2015 /849/ EU. However, the recent amending Proposal includes new enhanced customer due diligence measures in case of transactions involving high risk third countries: see art. 18 *bis* of the amended Directive n. 2015/849.

[25] See art. 13, par. 1, let. *a)* and *b)*, Directive n. 2015/849/EU. See, i.e., PISANI, *Gli obblighi di adeguata verifica della clientela nella disciplina antiriciclaggio*, *Il fisco*, 2008, 1, p. 1789 ff.; STAROLA, *I criteri connessi agli obblighi di adeguata verifica e di identificazione della clientela*, in *Corr. trib*., 2009, p. 882 ff.; COSTANZO, *The risk-based approach to anti-money laundering and*

on the client itself, which by hypothesis could be a company, but on the beneficial owner of the operation or transaction. According to the definition the Fourth Directive provides for in art. 3, n. 6, «*beneficial owner*» is any natural person(s) who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted. The experiences gained in the AML implementation and enforcement over the last years led the EU policy- and law-makers to revise the very criteria to determine the beneficial ownership, both by specifying some circumstances and by broadening the net as to capture situations that were overlooked in the previous Directive.

In that respect, it is worth noting that now, in contrast to the previous Directive, when it comes to corporate entities, the «*ownership*» (of a sufficient percentage of the shares or voting rights) or «*control*» in that entity could occur even through «*ownership interest in that entity*». Such an extension is most likely driven by the intention to make the scope of the AML legislation include corporate entities which capital is not formed technically by shares but by "ownership interests" (non-stock entity such as a partnership or an LLC) or quotas (as, for instance, the Società a Responsabilità Limitata in the Italian company law system). Likewise, «ownership interest in that entity» is certainly be added as to comprise in the material scope of the legislation the financial instruments which enable the holder, irrespective of the entitlement to specific voting rights, to eventually influence the company (the so called "participating financial instruments" that might or might not have economic or voting rights depending on the company statutes).

Besides, by means of a disposition which looks like a closure declaration, the Fourth Directive adds to the other situations of beneficial ownership the case of «*the natural person(s) who hold the position of senior managing official(s)*», but only «*after having exhausted all possible means and provided there are no grounds for suspicion, no person under point (i) is identified* [*id est*, direct or indirect ownership or con-

counter-terrorist financing in international and EU standards: What it is, what it entails, in *Research Handbook on Money Laundering*, B. Unger e D. van der Linde (eds.), cit., p. 349 ff.

trol], *or, if there is any doubt that the person(s) identified are the beneficial owner(s)*» (art. 3, n. 6), let. *a), ii)*). Completely different was the case, under the previous Directive, of the «*the natural person(s) who otherwise exercises control over the management of a legal entity*».

Coming back to the case of ownership or control through direct or indirect ownership of a sufficient percentage of the shares or voting rights, bearer shareholdings are to be considered relevant for determining the beneficial ownership (in accordance with the Third Directive). The inclusion of bearer shares, which might at first sight beg some questions, seems to be driven by a twofold objective.

First of all, the easy transferability of ownership by delivering the physical document makes it quite impossible for those who have to carry the customer due diligence (obliged entities) to constantly monitor the evolution of the shareholder structure. For that reason, the intention of the EU legislator might be traced in consequently asking the obliged entity to assess whether or not the conditions under which a shareholder qualifies as «*beneficial owner*» (i.e. more than 25% of total voting rights) occur at the time of the shareholders meeting[26]. In fact, what matters at the end of the day is above all the capability of affecting and influencing the corporate decisions (starting from the nomination of the members of the board and the audit committee) and this typically comes about during the shareholder meeting. However in this way, the "real" beneficial owner would be possibly allowed – and hence the reason for concern – to deliver the shares to a complacent and loyal nominee right before the shareholders' checks in order not to bring up their name in that forum,

[26]According to the amending Proposal the relevant threshold would be reduced to 10% «*whenever the legal entity is a Passive Non-Financial Entity as defined in Directive 2011/16/EU*»: once again, this is another step toward a more rigorous AML legislation, given that – as explained in the Explanatory Memorandum at par. 5, let. *i)*, as well as in the recital 18 – «*For intermediary entities that do not have any economic activity and only serve to distance the beneficial owners from the assets, the 25% threshold is fairly easy to circumvent. Establishing a lower threshold where there is a specific risk will limit the scope of entities on which the obliged entities would need to collect additional information to those where the risk of use for illicit purposes is high. Accordingly, this enables the better detection of beneficial owner(s) with particular focus on entities that function as intermediary structures, do not create income on their own, but mostly channel income from other sources (defined as Passive Non-Financial Entities under Directive 2011/16/EU)*».

making sure to have the shares back a moment later, and therefore retaining full control over the company on the factual level. In light of the perils and potential circumventions, the reason why plenty of national company law systems[27] impose the shares with voting rights to be nominative (for companies not listed on regulated markets, which are the only ones relevant here) is now clear[28]. In that respect, however, the EU legislator had their hands tied, since in designing the AML legislation it had to take into account also the national company law systems which, on the contrary, allow non-listed companies to issue bearer shares with voting rights (as happens for instance in Luxemburg[29] and in The Netherlands[30]). Therefore, the EU legislator prudently came to the conclusion to frame as the notion of «*beneficial ownership*» as wide as possible for anti-money laundering purposes, despite being well aware of some inner limitations as highlighted above.

However, there is a second objective behind the inclusion of bearer shares. Put in perspective, the "control" as capability of influencing the corporate decisions might not necessarily be the relevant factor for the purposes of the AML legislation, but rather the economic benefit that the hypothetical money launderer[31] draws from being a shareholder, in that they invest the "dirty" money in the subscription or purchase of stocks and thus obtain financial benefits under the umbrella of legality. Con-

[27]This is the case for example in France (see art. L. 212-3 *Code monétaire et financier*; art R224-2 *Code de commerce* narrows down the possibility to issue either nominative shares or bearer shares to listed companies only, which are not relevant here; see LE CANNU - DONDERO, *Droit del sociétés*[6], Paris, LGDJ, 2015, p. 726), in Italy (see, art. 2354, co. 1, Italian Civil Code and r.d.l. 25 October 1941, n. 1148, converted in law 9 February 1942, n. 96), in UK (see Sec. 112(2) Companies Act 2006).

[28]See also the FATF Recommendation 24: «*Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities… countries that have legal persons that are able to issue bearer shares or bearer share warrants, or which allow nominee shareholders or nominee directors, should take effective measures to ensure that they are not misused for money laundering or terrorist financing*».

[29]See art. 37 ff. law 10 August 1915 «*concernant les sociétés commerciales*». For anti-money laundering purposes, however, the recent law 28 July 2014 requires mandatory deposit of bearer shares to a depository company authorized to do so: on this subject, see CHARLIER- TAKERKART-WOLF-LICATA, *Réforme du régime des actions au porteurs*, in *ACE Compta- bilité, fiscalité, audit, droit des affaires au Luxembourg*, 2014, n. 10, p. 21 ff.

[30]See art. 2:82 Dutch Civil Code regarding the NV («*Naamloze Vennootschap*»).

[31]The same applies obviously to the terrorist financing.

sequently, the shares without voting rights – and even more so if bearer shares, given they are transferable by delivery – can, like those registered, be used for those purposes. Such an interpretative approach has been recently endorsed by an interesting decision of the Italian Banking and Financial Ombudsman (ABF)[32] which qualifies the threshold of 25% of the total shareholding enshrined in the AML legislation as a sort of irrebuttable presumption of "beneficial ownership". Such decision brings to the fore the economic benefit attached to a share irrespective of any additional (voting) rights which might entitle to influence the corporate governance[33]. If the shareholder owns a sufficient percentage of the shares (25% of the total shares) they are presumed to being able of deriving an economic advantage from it: this is the relevant factor in detecting the "beneficial owner".

Finally, the trusts are the last area relating to the identification of the «beneficial owner» to be dealt with. The previous Directive already provided for a set of rules on trusts, but those rules were addressed in the broader context of the legal entities, such as foundations, and legal arrangements, such as precisely the trusts, which administer and distribute funds. Furthermore, for the purposes of AML legislation, trusts were subject to the same threshold of 25% applied for companies, but of course in this case it refers to the future beneficiaries or to the exercise of control over the assets of the trust. The new Directive once again aims to broaden its scope of application by, on the one hand, listing as possible beneficial owners, the settlor, the trustee or the protector if any, the beneficiaries, or where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates, as well as any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means. On the other hand, the

[32]The Italian Banking and Financial Ombudsman (Arbitro Bancario e Finanziario) is an alternative dispute resolution system for customer complaints about banks and other financial intermediaries.
[33]See Arbitro Bancario Finanziario, Collegio di Milano, dec. n. 488, 22 January 2015 who also points out in this regard the need to put the specific purpose of the provision in question in the context of the customer due diligence requirements.

scope of its application is broadened by eliminating any reference to the 25% threshold. According to a strict reading, in most cases the beneficial ownership of a trust is to be attributed to several individuals, making therefore the customer due diligence particularly heavy to be performed.

Aiming at implementing concretely the principle of proportionality to the specific degree of risk of money laundering, the recent proposal of a new Directive draws a dividing line (just foreshadowed by the directive 2015/849/EU, where art. 31, par. 4, considers the trust that «*generates tax consequences*» only, expression which is not reproduced in the amended text), in brief, between trusts with a view to gain profit and other trusts such as having charitable intent or safeguarding of the family assets. Only the former type, like profit-making companies, are obliged (through integration not of the AML Directive, but rather of the already mentioned directive 2009/101/EC) to disclose the requirements regarding the beneficial ownership and other essential information to any third party and civil society in general, but at the same time – here instead revising the Fourth Directive – subjecting all trusts, without distinction, to the anti-money laundering requirements regarding beneficial ownership but by making available the information concerning the second type trusts no at anyone, but only to legitimate stakeholders (so the "new" par. 4a that would be added to the art. 31 of Directive 2015/849/EU).

On this point, however, the proposal appears lame and does not fit the purpose of effectively countering money laundering and terrorist financing. Most likely, the Commission has ambitiously aimed at more general objectives of "market transparency", which are not easily matching the AML ones. For that reason, it seems appropriate to make some adjustments along the way of drafting the final text of the amending directive.

5. In pair with the rules set out for the customer due diligence, the Fourth AML Directive introduces some new provisions (i.e. those of Chapter III, art. 30-31) specifically aimed at facilitating the investigations by the authorities entrusted with enforcement tasks. In that respect, according to art. 30, par. 1, the Member States en-

sure that corporate and other legal entities incorporated within their territory obtain and hold «*adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held*». Par. 3 requires the Members States to set up – where not already established – national central registers where all such information are collected, for example a commercial register, companies register as referred to in art. 3 of Directive 2009/101/EC, or a public register. The characteristics of those national mechanisms must be notified to the Commission, which will submit a report to the European Parliament and to the Council assessing the conditions and the technical specifications and procedures for ensuring the safe and efficient interconnection of the central registers referred to in par. 3 via the European central platform established by art. 4a(1) of abovementioned Directive 2009/101/EC.

In this regard, the proposal for amending the Fourth AML Directive, however, seems to head to a sudden and unexpected *revirement* by the European policy-makers. According to the current wording of the Fourth Directive, in fact, the access to the information at issue[34] should have been allowed not only to those subjects who are abide by customer due diligence obligations, to the competent authorities and the Financial Intelligence Units of the various countries, as obvious, but also «*to any person or organization that can demonstrate a legitimate interest*» (see art. 30, par. 4, par. 1, let. c). This, obviously, would open up (or, rather, would have opened up) the consultation of such databases to a potentially very large and diverse audience of stakeholders, for example, for investigative journalism purposes or scientific research, according to a clear and, in many ways, appreciable intent of increasing transparency of economic relations. At the same time, however, the AML regulatory system would ended up pursuing a range of different purposes: the contrast of terrorist financing activities, the fight – as seen above – of tax evasion and now the increase of information disclosure of the beneficial ownership regarding a wide set of relationships and

[34]The access to information must take place in compliance with the rules on data protection and for which the prior online registration might be provided for as well as the payment of a fee not exceeding the related administrative costs.

transactions. Hence, a legitimate doubt arises: only experience, in fact, could answer the question of whether such a trend *would* bring about positive synergies or if the original purposes of preventing and contrasting money laundering (nowadays unfortunately more relevant than ever) would be watered down in a patchwork of heterogeneous objectives.

We are using "would" because, even before such a provision comes into force in the national jurisdictions, the amending Directive opts for deleting the just mentioned let. c), with the first consequence that regarding companies and other «*legal entity*», if the amendment is confirmed, the access to information on the beneficial ownership would be guaranteed to the competent authorities, the FIU, the subjects obliged to perform the customer due diligence, but no longer to those who bear a legitimate interest. Nonetheless, should we take into account the simultaneous plan to amend Directive 2009/101 / EC, as already mentioned above, the exclusion of legitimate interest bearers does not concern profit-making companies (by far the majority), thus ending up partially confirming the trend marked by the Fourth Directive in favour of greater transparency in corporate disclosure and, consequently, the detected increasing versatility of the anti-money laundering measures.

6. As far as the supervisory architecture goes, the Fourth Directive pays much greater attention that the Third Directive to the matter of national and international cooperation between supervisors (as clearly emphasised in recital 54 of the Fourth Directive). The Third Directive in fact devoted only one concise article to cooperation (art. 38), which entrusted the Commission with the task to facilitate both coordination and sharing of information between the different Financial Intelligence Units (FIU, hereinafter). The Fourth Directive flashes out this subject in nine articles (from art. 49 to art. 57), distinguishing between national cooperation, cooperation with the ESA (i.e. with EBA, EIOPA and ESMA, the three authorities of the ESFS microprudential supervision, the European System of Financial Supervisors) and co-operation between

the FIU and the Commission[35]. Regarding the latter cooperation, the Fourth Directive is worded less rigorously than the previous one, since the Commission now «*may*» (instead of «*shall*», used in the Third Directive) lend assistance as may be needed to facilitate coordination. However, such a change is not to be overestimated, especially looking at the bigger picture and at the great deal of attention now paid to the cooperation.

The analysis on cooperation should be rather conducted from a different angle. When the Third Directive was enacted in 2005, the Single Supervisory Mechanism was obviously still far from even being intellectually conceived and the division of competences was based upon the distinction between banking supervision and monetary policy. Against that backdrop, it comes as no surprise that the Third Directive lacked any reference to the European System of Financial Supervision and its components, which came into existence a few years later, nor to the European Central Bank, which at the time was not familiar with the supervision of banks.

The architecture of banking supervision in Europe has however changed dramatically in the wake of the financial crisis. . After the entry into force of Regulation 1024/2013/EU and the subsequent setting up of the Banking Union, banking supervision is centralized in the hands of the European Central Bank, despite still being deeply rooted in the workflow carried out by the national supervisory authorities.

Nevertheless, despite mentioning the ESAs, no reference is made to the European Central Bank. And indeed, according to the reformed regulatory framework, at the epicenter of the system there is rather the European Commission, which is assumed to be «*well placed to review specific cross-border threats that could affect the internal market and that cannot be identified and effectively combatted by individual Member State*»; it should therefore be entrusted «*with the responsibility for coordinating the assessment of risks relating to cross-border activities*» (recital 24). This is

[35]The amending Proposal adds a fourth area of cooperation between competent authorities, listing a series of cases where any authority cannot in any way refuse the request for assistance from one or more of the others (see art. 50a, to be inserted in Directive n. 2015/849/EU).

reflected both in the aforementioned art. 51, which, despite the wording less strict than in the past, entrust the EC with an the role of facilitating the cooperation between FIUs, and, most importantly, in art. 6, according to which the EC in endowed with the role of conducting an «*assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities*». To that end, the Commission is requested, by the date the Directive is to be transposed, to draw up a report identifying, analysing and evaluating those risks at the Union level. Thereafter, it has to update its report every two years, or more frequently if appropriate.

Therefore, while the EU banking supervisory architecture resulted in a composite system leaded by the European Central Bank and supported in the day-to-day activity by the national supervisory authorities[36], for the AML system of supervision it has not been opted for setting up a sort of European central FIU. Indeed, establishing yet another European institution mostly engaged in the financial and banking supervision would not be welcomed. Instead, the Commission operates in the capacity of a sui generis central FIU, and to that end it provides guidance, regulation and control under its oversight powers[37]. The ESAs, on their side, have instead the responsibility of setting out «*draft regulatory technical standards*» (see art. 45, par. 6, par. 1, Directive 2015/849/EU), for example with reference to the compliance with the anti-money laundering requirements by the obliged entities that are part of a group, then to be brought to the attention, again once again, of the Commission.

Supposedly, the European legislator opted for not exploiting the proven synergies between banking supervision and the contrast of the criminal economy[38], neglecting, on the one hand, that the fight against the phenomena in question cannot be separated from the forefront involvement of banking supervisors that, precisely

[36]Regardless, here, to the interaction between the ESAs (primarily EBA) and the ECB. On this subject, among the many, see WEISSMAN, *European Agencies and Risk Governance in EU Financial Market Law*, Routledge, London, 2016.
[37]See in particular art. 45, par. 7 of the Fourth Directive.
[38]On this matter please refer to URBANI, cit., partic. p. 89 ff.

because of their mission, know very well the dynamics of circulation of money and, on the other hand, that a bank or financial intermediary "bent" to criminal economy is more vulnerable especially in light of its core business, and of its potential capability of altering the proper competition process in the market.

It casts no doubt, however, that new European supervisory landscape sees actively involved national supervisory authorities and, moreover, that the Fourth AML Directive requires the Member States to make sure that such authorities have adequate powers to ensure compliance with the AML legislation (see art. 48). Besides, since the material scope goes beyond just banking and financial intermediaries and indeed affects many other categories of persons who perform different activities, the Commission should be best placed, in the eyes of EU legislator, to counter any form of activity relating to money laundering or terrorist financing. However, in our humble view, the boundaries of AML regulatory and supervisory architecture are lately fading mainly as the result of the unintended consequences of considering the fight against money laundering to be intrinsically separated from banking supervision, ending up with the dispersion of potential synergies coming out from a more integrated system.

Such issue will most certainly gather momentum as soon as a proposal for a Fifth AML Directive will be drafted, as the recent amending directive unfortunately does not touch upon.

COMPOUND INTEREST AND ITS VALIDITY (OR INVALIDITY) IN THE BANK-CUSTOMER RELATIONSHIP: THE STATE-OF-THE-ART OF BRITISH COMMON LAW DISCUSSED BY VIRTUE OF A COMPARATIVE ANALYSIS

Pierre Sinclair*

ABSTRACT: *Compound interest is a concept that, historically, has been tainted with an essentially mercantile flavour. It relates to the custom of banks in capitalising on the interest due by a client upon the expiry of a certain interval (the rest). Such practice, zealously vilified in some quarters, whilst acclaimed as a prosperous enterprise in others, has been challenged more recently at both judicial level and under statute, in the case of Italy. This contribution, in briefly recalling the origin of the concept of anatocism (the orthodox definition of compound interest) and, therefore, its Roman predecessor, the usurarum usurae and the futurarum usurarum usurarae (usurae), seeks to examine the state-of-the-art apparatus applicable to compound interest in the English common law. Such deliberations will thereupon give rise to what this paper aspires to describe as a peculiar development. In this respect, attention is drawn to the recent Consumer Rights Act 2015 and the manner in which the bank customer is theoretically entitled to rely upon it, with specific reference to the compound interest clause. As regards the 'Continental experience', the Italian jurisdiction, awash with judicial twists and incandescent doctrinal views on this topic, is discussed and analysed as a compelling and stimulating comparator.*

* Associate Professor of Business Law, School of Management & Languages; Dept. of Business Management, Heriot-Watt University, Edinburgh (United Kingdom).

SUMMARY: 1. The etymology of a legal concept. - 2. The epistemology of a legal concept: the Roman law tradition and glimpses of a diachronic analysis. - 3. The compound interest from a common law point of observation. - 3.1. The rationale behind the compound interest in Britain and the historical development. - 3.2 Britain and statute. - 3.3. Britain and compound interest: a summary. - 4. The civil law position: Italy. - 4.1 The Italian Civil Code and the general rule of the invalidity of the compound interest. 4.2 The validity of the compound interest in the Italian Civil Code. - 4.3 Compound interest and the Italian banking legislation. - 5. A critical analysis and conclusion

1. The term 'compound interest' has been widely favoured for use both in common law and in the English speaking world,[1] whereas its Latin-based counterpart has opted for the more sophisticated term *anatocisme* (French) or *anatocismo* (both Spanish and Italian). The Latin *anatocisum* is derived from an ancient Greek term that, in turn, is a portmanteau of ANA and TOKOS. The former literally translates to 'above' while the latter signifies 'a product' and originates, albeit more remotely, from the verb TIRKO, more specifically 'to produce'. Ultimately, the portmanteau and its liaison with the expression 'compound interest' are somewhat intuitive and comprehensible: the anatocism, or, to apply the English terminology, the compound interest, is an agreement or, in some cases, merely a usage, whereby the creditor requests that the debtor execute the repayment, in connection with a balance (whether due or not), of an accrued sum of interest.

This sum of interest, differently from the simple interest, is not calculated on the capital,[2] but rather on the original capital plus the interest accrued during a specific or implied period,[3] commonly referred to as the rest. In other words, compound interest is a variant capable of producing interest for a future time span, such as a year, half a year or a quarter. It is clear that, from the debtor's perspective (whether or not he is a borrower or a guarantor or any person under an obligation to reimburse any pecuniary obligation to the creditor), the application of

[1]In Dutch, a further German language, the terminology is more similar to the English one: *samengestelde rente*, which literally means 'compound interest'.
[2]The Latin *sors*.
[3]It is a month, a term, a semester, a year.

compound interest may not afford him the most comfortable position. Yet, this concept is one of those topics that, when subjected to a comparative analysis, brings to light the most intriguing discrepancies between common law and civil law, and specifically two jurisdictions, the English and the Italian one.

The analysis will evolve through a discussion of both legislative sources and the relevant judicial precedents. The theory that will ultimately be corroborated in this contribution is that not only is the *ius positum* of the two jurisdictions diametrically at odds with each other, but that any possible convergence of the two is far from becoming a reality in the near future. Within such a context, the Roman law ancestor shall be wielded as an epistemological instrument as a means of highlighting, perhaps boldly, some inconsistencies of each of the two modern legal systems under scrutiny.

2. The topic of the compound interest reveals obvious and fascinating ties with the past and, surprisingly, an unexpected slight departure from the forebear of law itself, Roman Law.

In order to explain this, it is worth recalling that the *usurae supra duplum* were regarded as unlawful if the relevant clause was embedded in a contract. The usury, a phenomenon connected with the compound interest, was also prohibited as early as the Republican era: the *Lex Genucia*, dating back to 342 B.C., prohibited the practice, whereas a later *Lex Marcia*, probably dated 104 B.C., punished the shark lenders with the *manus iniectio pura*.[4] As recalled doctrinally,[5] the prohibition of the *usury* is ascribable to an Ulpianus' quote:[6]

'*Supra duplum autem usurae et usurarum usurae nec in stipulatum deduci nec exigi possunt et solutae repetuntur, quemadmodum futurarum usurarum*

[4]See VOLTERRA, *Istituzioni di Diritto Privato Romano* (Edizioni Ricerche, Rome 1961) 483.
[5]See CHERCHI, *Ricerche sulle 'Usurae' Convenzionali nel Diritto Romano Classico* (Jovene Editore, Naples 2012) 143-156.
[6]See ULPIANUS, 26 ad ed. D. 12.6.26.1.

usurae'.[7]

Likewise, as recalled by Cicero,[8] an opinion provided by the Roman Senate, the *senatusconsultum*, in the republican era, strongly banned the practice of the compound interest, usually associated with the usury.

The phenomenon of the *futurarum usurarum usurae* (the compound anatocism), therefore the compounding of the interest on a sum of interest, when the latter and the capital are not yet due, was prohibited in the Classical period. Seemingly, the reason lies on the fact that the creditor could not input to the capital (the Latin *sors*) an interest if the debtor was not yet under an obligation to return it.[9] Ulpianus' extract seems to suggest that the *usurarum usurae* too (the simple anatocism) was prohibited. This is the compound of an interest on the capital when the latter is already due. However, this reference might have been interpolated later, during the Justinian period.[10]

In the subsequent Justinian era, however, the *usurarum usurae* became an autonomous concept, independent of the *usurae supra duplum*,[11] therefore the interest exceeding the amount of the capital. More specifically, *usurarum usurae*, whether *futurarum* or not (therefore, whether on a capital not due yet or already due), became certainly prohibited.[12]

3.

[7]Basically: 'The interest above as much twice as the value of the capital as well as the compound interest connot be agreed upon, nor is the repayment possible, and the usury interest already paid could have been claimed back, whether or not the capital is already due.'

[8]See CICERO, ad Att., 5, 21, 12. It is recalled (VOLTERRA (n 4) 484) that the prohibition had been preceded by a ruling which banned the compound interest according to a monthly rest.

[9]See, in a convincing way, CHERCHI (n 5) 144. See also VOLTERRA, *Istituzioni di Diritto Privato Romano* (n 4) 483-484.

[10]This is suggested by some scholars: eg GUARINO, *Diritto Privato Romano* (Jovene Editore, Naples 2001) 800. *Contra*: CERVENCA, *Sul Divieto delle cd. "Usurae Supra Duplum* (1971) II Index 291 ff.

[11]See PIKULSKA, *Anatocisme*. C. 4,32,28,1: *Usuras Semper Usuras Manere* (1998)45 *Revue Internationale des Droits de l'Antiquite*, 429-449; MURILLO VILLAR, *Anatocismo. Historia de una Prohibición*, (1999)69 *Anuario de Historia del Derecho Español* 497-518.

[12]The adjective 'compound', now associated with the noun 'interest', may reveal the legacy of the 'compound anatocism' existing in Roman Law. See A Cherchi (n 5) *passim*.

3.1. The compound interest at common law would appear to be, particularly in the case of England, a concept unadulterated by unlawfulness. The legitimacy of the practice seems to rest on a fiction: on a certain sum of money that is lent by a bank to a client, the capital and the interest are virtually repaid and relent in the books, either on a yearly rest or a half-yearly one. However, the relevant sum that is lent for the following period will include also the interest (the compensatory one) previously accrued on the original capital. This is tantamount to saying that capital and interest are compounded for the following rest.

Historically, this practice dates back to a time when in England there was a specific statute which prohibited the usury interest. According to the legislation then in force, of a criminal nature and hinged upon a piece of legislation of 1545,[13] it was prohibited to charge interest exceeding a specific percentage, initially fixed at ten per cent per annum. This percentage, over the following centuries and until the 19th century, was repeatedly scaled down by the English legislature to the point where a more modest and less remunerative (for the banks) level of five per cent per annum was established. Any contract that allowed for an interest rate percentage exceeding the legal threshold would be instantly rendered void; further, any banker who, for a specified loan, overstepped the applicable threshold would be regarded as a potential perpetrator of a criminal offence.

As a means of sidestepping the aforementioned pitfalls, bankers envisaged a stratagem or, as just alluded, a fiction. Upon expiry of a specific period (the half-yearly or yearly rest), the loan should have theoretically been re-paid. In relending the money, though, the amount given to the client was not the original one, but the sum of the capital plus the interest accrued in the previous rest. The interest, calculated on the original capital, plus the interest accrued in the previous rest, no

[13] As recalled by Lloyd LJ in *National Bank of Greece SA v Pinios Shipping Co* [1989] 3 WLR 1330 (HL) at para 653. This piece of legislation is the Usury Act 1545, 37 Hen 8 c 9.

longer required the lender to fix an excessive percentage of interest.[14] Formally, the banker applied a rate within the legal limit also on the capital for the following rest. However, it is obvious that, in reality, the capital was not the pure capital, but rather the compounding of the original capital plus the interest accrued in the previous rest. It is consequential and logical that, without this myth, *ergo* the repaying and relending upon expiry of a specific rest, the interest rate would have been almost certainly usury. The banker, in applying the interest on a pure capital without compounding, would have had no option but to apply a very high interest rate, in order to secure adequate remuneration.

Despite some obvious perplexities of an ethical nature, this banking practice was regarded as lawful at common law, albeit with some *caveats* in term of applicability. As per Lord Cottenham L.C.'s remarks in consideration of *Fergusson v Fyffe*:[15]

'Generally a contract or promise for compound interest is not available in England, … except perhaps as to mercantile accounts current for mutual trans-actions …'

Some decennia before, at the beginning of the 19th century, in *Ex parte Bevan*,[16] Lord Eldon had already hinted at this principle and a possible validity of the compound interest:

'So this is legal between merchants; where there is no agreement to lend to either; but they stipulate for mutual transactions, each making advances; and that, if at the end of six months the balance is with A., he will lend to B., and vice versa.'

The usury law was abrogated later, in 1854, as a result of the Usury Laws Repeal Act 1854.[17] However, the compound interest, which to a certain extent was a consequence of that piece of legislation, somehow persevered thereafter, alt-

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[14]See also Section 4 below, particularly the minority, albeit persuasive, school of thought existing in Italy, where the phenomenon of the capitalisation of the interest in the banking current accounts is interpreted in the same way.
[15](1841) 8 Cl & Fin 121,140.
[16](1803) 9 Ves Jun 223,224.
[17]See 17 & 18 Vict c 90.

hough that abrogation had removed the *ratio essendi* of the practice. Needless to say, the process of validating the compounding of interest in a *corpus iuris* where the usury is no longer a criminal act, was not so straightforward.

A first, albeit timid, opening move in addressing the compound interest in the post-usury era is the Court of Appeal *decisum* in *Deutsche Bank und Disconto Gesellschaft v Banque des Marchands de Moscou*[18]. The legality of the practice is indirectly - indeed decidedly indirectly - inferable from Scrutton LJ's remarks[19] in commenting on *Fergusson v Fyffe*.

'The House of Lords in *Fergusson v Fyffe* treated compound interest as not payable, except perhaps on mercantile accounts current for mutual transactions'.

In essence, *Deutsche Bank und Disconto Gesellschaft* held that the compound interest practice was valid exclusively in connection with mercantile bank accounts. For transactions of a different nature, the stance which the courts would adopt was left unclear, although the tenor of Scrutton LJ's statement appeared to suggest that a further extension of its valid practice was unlikely.

However, and not without surprise, the more recent landmark case, 'Pinios',[20] marked a new chapter in the judicial attitude towards the issue of compound interest. In this case, Pinios Shipping Co. bought a ship. Pursuant to the relevant contract, part of its purchase price (70%) would be paid by the purchaser in force of 14 six-monthly instalments. On its turn, the payment of this balance would be secured, on the one hand, by a first mortgage on the vessel granted by the purchaser in favor of the builders. On the other hand, the National Bank of Greece SA (the Bank) guaranteed the payment of the first six instalments, whereas a second mortgage and a personal guarantee from another person afforded the necessary protection to the Bank. Due to a builder's non-performance of its own obligations, Pinios failed paying the first two instalment; therefore, the Bank was

[18][1931] 4 L.D.B. 293. See also *Yourell v Hibernain Bank ltd* [1918] AC 372 (HL).
[19]Again, see the '*Deutsche Bank und Disconto Gesellschaft*' *decisum* (n 18) at p 295.
[20]See *National Bank of Greece SA (Appellant) v Pinios Shipping Co No 1 and Another Respondents* (n 13).

called on to pay these two instalments under the guarantee. However, the ship was in the meantime lost at sea and the insurance monies received were insufficient to enable Pinios to repay the Bank under the second mortgage. The Bank made a written demand to Pinios to get the repayment of the second mortgage. Because Pinios failed to pay the Bank, the latter sued, claiming the amount owing under the mortgage plus interest. The Court of Appeal held that, since the second mortgage contained no provision entitling the bank to charge compound interest, the bank's entitlement to charge compound interest ended when the bank made its demand for repayment and thereby terminated the bank/customer relationship. However, the House of Lords overturned this decision and affirmed that the entitlement of the Bank to charge compound interest extended to the following period.

The *decisum*, which can be regarded in a non-legal discourse as bank-friendly, slightly overturned *Deutsche Bank* in holding that a term arranging for a compound interest should be construed to be a natural consequence of a contract existing between a bank and a client (not necessarily of a mercantile nature, but of any nature), with its usage extended also to transactions concluded beyond the bounds of those exclusively connected with bank accounts. The only qualification introduced by the neo-liberal 'Pinios' *decisum* is that the term is implied exclusively for mercantile transactions, whereas in other cases (therefore, it is assumed in this paper, in the relationship with a consumer) a specific term is necessary for the compound interest to be valid.[21]

A further principle introduced by the 'Pinios' *dictum* is that the compound interest can be charged not simply until such time that the bank asks for payment, but also in the subsequent period, in circumstances where the due amount has not yet been fully repaid and, seemingly, the relevant account is already closed. The

[21]For comments on 'Pinios', see *Banks and Compound Interest* (1990) *Journal of Business Law* 331-333; MANN, *Problems of Compound Interest*, (1990)106 *Law Quarterly Review*, 176-179; KINGSFORD-SMITH, *The Banker's Right to Compound Interest*, [1990] *Lloyd's Maritime and Commercial Law Quarterly*, 489-491.

comments of Lord Goff of Chieveley are worthy of contemplation: if the banker is entitled to capitalise interest, 'there appears to be no basis in justice or logic for terminating that right simply because the bank has demanded payment of the sum outstanding in the customer's account.'[22] The entrenched principle (*ergo*, entitlement to charge compound interest until and not beyond the request of payment), established as early as *Fergusson v Fyffe*,[23] was based on the distinct assumption that, once the account had been closed, the compound interest shall no longer be chargeable and, from this time onward, the bank is entitled to gain from a simple interest only. Additionally, a dilemma, namely whether compound interest can be charged exclusively on yearly or half-yearly rests, was resolved by a further court decision, *Kitchen v HSBC Bank plc*.[24] In this case, it was held that the usage of quarterly rests can be regarded as consistent with the functioning of modern banking practice.

For reasons of completeness of analysis, it is worth mentioning that English courts have ruled on the notion of compound interest also as regards the possible connection of the notion with the cognate construct of restitution of sums paid by mistake and, therefore, claims for unjust enrichment. In *Sempra Metals Lts v Inland Revenue Commissions*[25] it was held that the court had a common law jurisdiction to award interest, simple or compound, for damages on claims for non-payment of debts as well as on other claims for breach of contract and in tort. However, more recently, legal scholars[26] argue that this court decision erroneously equates the time value of money with compound interest, whereas the alternative 'benefit choice' approach to the time value of the money, endorsed by more re-

[22]See *National Bank of Greece SA (Appellant) v Pinios Shipping Co. No 1 and Another Respondents* (n 13).
[23]8 Cl. & Fin 121.
[24][2000] 1 All ER (Comm) 787, 791.
[25][2007] UKHL 34, [2008] 1 AC 561.
[26]See HSIAO, *A Shift in the Objective Measure of the Time Value of Money*, (2015)23 *Restitution Law Review* 92-105.

cent *decisa,*[27] seems to be more persuasive.[28]

3.2 In Britain, distinct from a civil law comparator,[29] banking legislation does not provide any legal provision specifically designed to regulate compound interest.[30] A bank customer, technically speaking, is not protected by *ad hoc* rules. As correctly suggested by scholars,[31] the only macro-system of norms safeguarding the bank customer is that already in place for any other customer: the Unfair Contract Terms Act 1977 (UCTA 1977) and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR 1999).[32] Actually, these two pieces of legislation have been amalgamated, very recently, in the Consumer Rights Act 2015 (CRA 2015).[33] In regard to this newly enacted statute, section 62, in a way not so dissimilar from, nor identical to what was established in the previous UTCCR,[34] would appear to contain a norm that may offer some protection to the bank customer. *Mutatis mutandis*, the compound interest clause would be unfair, and therefore invalid, if (a) it gives rise to a 'significant imbalance in the parties' rights and obligations',[35] and (b) the term is 'contrary to the requirement of good faith'.[36] The natural consequence of a term being ruled to be unfair would be the lack of enforceability attached to it. As per s 62(1), an unfair term of a consumer contract 'is not binding on the consumer', although the same consumer is not prevented 'from relying on the term … if the consumer chooses to do so', pursuant to the following s 62(3).

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[27]See *Benedetti v Sawiris* [2013] UKSC; [2014] AC 938.

[28]The link between a *quantum meruit* action for unjust enrichment and the notion of compound interest seems to be a peculiarity of common law. However, it does not take into account that compound interest is a mechanism merely of a banking nature.

[29]See the following Section 4.

[30]Such as the *Financial Services and Markets Act 2000*.

[31]See ELLINGER, LOMNICKA, HARE, *Ellinger's Modern banking Law* (OUP, Oxford 2011) 763.

[32]SI 1999 no 2083.

[33]Chapter 15. The Royal Ascent to this piece of legislation was given on 26 March 2015. The legal provisions applicable to the matter in discourse have started being applicable as from 1 October 2015.

[34]Particularly regulation 5(1).

[35]S 62(4).

[36]S 62(4).

In respect of the two alternative elements discussed above, subsection (b) would appear to present significant cause for concern on the part of the customer, also in light of the fact that, in Britain, the local central bank is not empowered to establish the average level of rates applicable to the range of specific banking transactions. In modern civil law jurisdictions, the interest rate applicable to a specific transaction shall be presumed as usury if it exceeds a certain threshold, established from time to time by the local authority.[37] Conversely, in Britain, where a possible infringement leading to criminal proceedings is not accounted for, the consumer would appear saddled with a decidedly onerous task in seeking to successfully lodge a legal claim if he wanted to corroborate that the compound interest has given rise to a significant imbalance in the parties' rights and obligations.[38]

Admittedly, a moderate form of relief is afforded to the bank consumer by the *Lending Code* (the LC), the code of practice promoted under the aegis, mainly, of the British Banking Association. This framework, in its latest version,[39] seems to suggest that any interest rate levied on the clientele must be explicitly communicated, therefore expressly agreed between the parties. The rule is encompassed within Section 5 of the LC, under the heading 'Current account overdraft'. In the pre-sale information usually provided by the credit institution, it is suggested that the customer 'must be provided, where relevant, with details of any charge payable, the interest rate to be applied or, if reference interest rates are to be used, the method for calculating the actual interest and the relevant date and index or base for determining such reference interest rates.'[40] It is further elaborated, under Sec-

[37]See, in Italy, Banca d'Italia, Tassi Effettivi Globali Medi.
As from 14 May 2011, any rate applied to a transaction exceeding by more than eight point percentages the average rate (the Annual Percentage Rate of Charge) ascertained by the same Bank of Italy, shall be regarded as usury.
[38]The bank could always argue that the unfavourable practice of the compound interest is more than compensated by the opportunity for the customer to have access to the credit.
[39]See BBA and UK Cards Association, *The Lending Code. Setting Standards for Banks, Building Societies, Credit Cards Providers and their Agents* (March 2011, revised on 28th September 2015) <http://www.theukcardsassociation.org.uk/wm_documents/2011%20Lending%20code%20%20-%20revised%20Sept%202015.pdf> accessed 12 October 2015.
[40]Rule 77.

tion 5 below, that the banks subscribing the LC 'should make information about overdraft interest rates available to customers' through 'a telephone helpline', 'a website', 'notices in branches' or 'information from staff'.[41] A similar suggestion, concerned with interest rates, is conveyed to credit cards providers to regulate the manner in which interest rates of the credit cards are charged and communicated to customers.[42]

Needless to say, the LC places no legal obligations on banks in respect to how they operate, although it may act as a framework of moral and good practice that providers, also in the area of the compound interest, 'feel' obliged to abide by according to principles of fairness. It is more dubious whether the customer may rely on this framework in order to sue a bank which decided not to comply with its guidance. As things currently stand, particularly in light of the fact that no domestic legislation currently provides a mandate to the code in order to protect the bank customer, any pursuit of a claim through the courts would invariably be futile.[43] Symbolically, the only avenue open to the customer or any consumers' association is to use the lack of compliance as a basis on which to mount an assault on the reputation of the bank concerned. Nevertheless, it is regrettable that compound interest is not acknowledged in the LC, as it is mingled with the general concept of interest rates and the way they are calculated: too little, too late! The protection afforded to the bank customer in Britain, in such a sensitive area of the customer-bank relationship, has proven to be very limited.

3.3. In reflecting both on British case law and on the relevant statute, it can be affirmed, albeit with a certain degree of approximation, that there are fundamentally four main principles as far as the compound interest is concerned.

[41] Rule 90.
[42] Section 6, Rule 113, LC.
[43] Ombudsman.

- At common law, compound interest is a fiction, viz. the consequence of the reciprocal lending and re-lending between bank and customer upon expiry of every rest. This myth originates from the usury law and is a legal device for lenders to avoid what, otherwise, would be the obvious perpetuation of a crime. However, upon the abolition of the usury law in the mid-twentieth century, compound interest, instead of passing away quietly by virtue of 'natural causes', somehow managed to persevere.
- It was with the 'Pinios' case that the practice of compound interest, merely alluded to in prior case law,[44] became an autonomous and fully recognised *genus*. In this *decisum*, compound interest is acknowledged as implied for mercantile transactions, whereas it requires an express contractual term to be applicable to other typologies of banking activities.
- Additionally, a further protection of the consumer is achieved by means of a non-legislative framework. Specifically, the *Lending Code 2011* requires that British banks ensure that compound interest is charged exclusively in cases where a specific term is embedded in the contract.[45] However, the LC is far from affording the bank customer a judicial recourse on which to stake a claim, rather it merely requires that the compound interest be made explicit in the contract.
- Residually, in Britain, the protection of the bank customer, as regards the compound interest, rests exclusively on the laws aimed to protect the consumer, more recently enshrined in the Consumer Rights Act 2015, specifically in s 62. This statute is the legacy of the previous UTCCR 1999, particularly regulation 5. However, the relevant legal provisions, albeit theoretically applicable to the bank customer, has never been notably invoked vis-à-vis the British courts, with regard to the concept of compound interest.

4. Of the various comparators that theoretically could have formed the ba-

[44] *Deutsche Bank und Disconto Gesellschaft v Banque des Marchands de Moscou* (n 17).
[45] See specifically section 4 and section 5 of the Code.

sis of a revealing comparison with the British system, the Italian jurisdiction provides a particularly apt comparator. The choice is not coincidental. Italy is a country where compound interest is legislated upon within the Italian Civil Code (ICC). However, a specific piece of legislation has been passed to cover banks and intermediaries. The interaction between this *ad hoc* legislation and the ordinary one, encompassed within the ICC, has engendered a serpentine position of the Italian judiciary. These diverse and fluctuating stances are highlighted in this Section.

4.1 In the ICC, the manner in which compound interest is treated would appear to be quite straightforward:

According to art 1283 of the ICC, the due interest shall not usually accrue additional interest, *ergo* compound interest. The compensatory interest that generally accrues on any sum owed by the debtor to the creditor[46] is calculated, from time to time, on the original capital. However, the capital shall not encompass the future interest, neither the compensatory one nor the punitive one.[47] Accordingly, any clause in the contract arranging for a compound interest shall be rendered invalid. This concept of invalidity has been reinforced by recent court decisions[48].

Despite the general invalidity of compound interest, two exceptions are usually conceded: one is contemplated in the same Civil Code and is detailed in the following Section 4.2; the second one is enshrined in banking legislation (Section 4.3 below).

4.2 The entitlement of a creditor to demand compound interest is recog-

[46]In the Italian language and pursuant to the jurisdiction, this interest is defined as '*interesse corrispettivo*', roughly compensatory interest. The compensatory interest is the natural consequence of an amount of money borrowed by a debtor. It is charged on the debtor, simply because he has availed of a good - the money - and has taken advantage of that. See IUDICA, ZATTI, *Linguaggio e Regole del Diritto Privato* (CEDAM, Padua 2015) 258. In the ICC this is reiterated by art 1282.

[47]The penalty interest is due by the debtor for the damage caused by the lack of performance, simply by the late performance. In Italy this interest can be charged, and it is perceived as legitimate (art 1224, ICC).

[48]Italian Supreme Court, no 6518 of 22 March 2011.

nised in some specific circumstances. The general condition for this is that the compensatory interest must have been due for at least six months. If this is the case, the compound interest shall be charged in accordance with one of two possible procedures:

a. First, there shall be a judicial claim aimed at the restitution of the compound interest;[49] or

b. There is a specific agreement, subsequent to the expiry of the compensatory interest, and this agreement expressly recognises the right to demand compound interest (art 1283, ICC).

Furthermore, irrespective of whether or not one of the conditions above is met, the prohibition on compound interest is derogated by art 1283 and therefore to charge compound interest shall be lawful - in cases where there were specific practices of a normative nature[50] (the so called '*usi normativi*'). For the derogation to be valid and, therefore, the compound interest to be legitimately charged, the practice is required to be of a normative nature. The dilemma, therefore, is to distinguish practices which are normative from those which are merely contractual. A practice of a normative nature is defined, doctrinally,[51] to be characterised by two elements: (a) the general and regular repetition, in a certain environment and for a protracted period of time, of a certain kind of behaviour; (b) a compliance with that behaviour in the environment so as to suggest that behaviour is regarded not simply as practice, but also necessary.[52] If the latter element (b) was missing, that practice shall not be normative, but merely contractual, thereby not giving rise to any contractual obligation. Conversely, a practice of a legal/normative nature is a source of law; as a result, any individual or person who claims a violation of a right originating from such a source will have the right to raise a legal claim vis-à-vis a

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[49]Italian Supreme Court, no 21340 of 18 September 2013.

[50]The 'usi normativi' in Italian, literally the 'normative usage' or, better, the 'legislative usage'.

[51]See TORRENTE - SCHLESINGER, *Manuale di Diritto Privato* (22nd edn Giuffre' Editore, Milan 2015) 37-38.

[52]This is the further element that, in Roman law terminology, shall be regarded as *opinion iuris ac necessitatis*.

court, seeking any judicial remedy required to protect that right.

4.3 To charge compound interest is a common practice in the banking sector, including in the case of Italy. Historically, the legitimacy of the compound interest in Italy rested on some entrenched decisions of the Italian Supreme Court, the *Corte Suprema di Cassazione*.[53] The reasoning underlying these rulings is the following one: art 1283 of the ICC allows a creditor to charge compound interest, so long as there is a practice which is normative in nature. Banks, including those in Italy, are conditioned by custom to fixing the terms and conditions of their main transaction on forms, each of the transactions/operations they offer to the market. These forms, in Italy traditionally promoted under the aegis of the Italian Banking Association and referred to as *Norme Uniformi Bancarie*, represent a normative usage, as they are applied uniformly to the clientele. For years, this practice of the banks had never been challenged as it was regarded to be of a normative/legislative nature, according to the requirements of the ICC. As a direct result, banks were entitled to charge compound interest.

However, this pillar of custom was unceremoniously uprooted by an unexpected decision of the Italian Supreme Court, no 2374 of 16 March 1999, which was immediately echoed less than two weeks later in the same Italian Supreme Court, no 3096 of 30 March 1999. The bottom line of these court decisions was that customary banking practice in charging compound interest was not decreed as tantamount to a legislative usage, but rather equated to mere commercial practice. Such a practice does not have the required element of the *opinion iuris ac necessitatis*. As a result of this, it was not lawful for the banks to charge compound interest due simply to the fact that the condition under art 1283 was not met. The usage is merely contractual, whereas art 1283 of the ICC requires that the practice be legislative in nature.

[53]Italian Supreme Court 15 dicembre 1981, no 6631; Italian Supreme Court 19 agosto 1983, no 5409; Italian Supreme Court 6 giugno 1988, no 3804.

The potential repercussions of the above court decisions were only too obvious to the Italian legislature, which had little option but to batten down the hatches. The unexpected decisions of the Italian Supreme Court would have put at risk the business of so many financial institutions. Clauses in bank accounts, loans and other forms of lending to the clientele, entitling the bank to charge compound interest, would have otherwise been regarded as null and void.

The outcome of this was the passing of a new statute, viz. the Legislative Decree 4 August 1999, no 342. This piece of legislation amended the Italian banking legislation, specifically the Legislative Decree no 395 of 1 September 1993 (the Italian Consolidated Banking Act or ICBA), particularly art 120.[54] According to the novel paragraph 2 of art 120 of the ICBA, a Governmental Body (the *Comitato Interministrariale per il Credito ed il Risparmio*, the CICR) was given a mandate to establish 'modalities and criteria for the accrual of interest on the interest in the banking transactions', so long as the interest – either the active one charged by the bank to the clientele[55] or the passive one due by the bank for its own liabilities[56] – accrues in accordance with the same rests.[57] Fundamentally, the CICR, in force of its decree issued on 9 February 2000 and which entered into force on 22 April 2000,[58] stipulated that 'the debit and credit of the interest shall occur based on rates and with a periodicity established in the contract' (art 2(1)), provided that 'as regards the same bank account the identical periodicity shall be established in the

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[54]The original art 120 was made up of a simple paragraph stipulating as follows:
'The interest on payments with a bank of cash, checks issued by the same bank or banking checks drawn on the branch where the payment is executed accrues with the same date when the payment is made and until the date of the withdrawal.' (our translation)
For commentaries on the original art 120, ICBA, see TALIERCIO, *Trasperenza delle Condizioni Contrattuali*, in P Ferro-Luzzi and G Castaldi (eds), *La Nuova Legge Bancaria III* (Giuffrè Editore, Milan 1996) 1854-1859; DONVITO, FERRAJOLI, RODALI, SILLA, *Commentario alla Legge Bancaria* (Il Sole 24 Ore, Milan 1997) 273.
[55]For instance, loans and other lending transactions.
[56]An example can be bonds or bank accounts.
[57] For commentaries on this penultimate version of art 120, ICBA, see CARRIERO - CASTALDI, *Commentary to Art 120*, in F Capriglione (ed), *Commentario al Testo Unico delle Leggi in Materia Bancaria e Creditizia* (2 nd edn CEDAM, Padua 2001) 926-935,
[58]See MANZI, *Commentary to Art 120*, in F Capriglione (ed), *Commentario al Testo Unico delle Leggi in Materia Bancaria e Creditizia III* (3rd edn CEDAM, Padua 2011) 1756.

calculation of the interest both the active and the passive one'.

In the immediate aftermath of the passing of the CICR decree, the area of compound interest in Italy enjoyed a comparatively untroubled period of tranquillity, although the truce did not extend sufficiently to placate some remaining grey areas. Among these, it was unclear and thus debated extensively whether the decree of the CICR, implementing the new wording of art 120, was a retrospective norm, intended to apply to bank accounts opened prior to the new legislation coming into force. In this case, the compound interest clause encompassed within these contracts would have been regarded as invalid. The alternative position (*ergo*, the new art 120 being innovative, rather than retrospective) would have rendered all contracts entered into before the judicial U-turn of 1999 as valid, in respect to the usage of compound interest. In the judicial battle that stemmed from this dispute, with the Italian lower courts demonstrating no evidence of a consistent pattern of rulings, it was the Italian Supreme Court that, in a plenary meeting, decreed all compound interest clauses existing prior to the Court decision of 1999 to be unlawful.[59] The rationale behind this decision is straightforward:

'[T]he clauses of quarterly capitalisation of the interest represent a violation of the prohibition of compound interest as set forth under art 1283 of the Italian Civil Code, for the reason that there is no such thing as a legislative usage, nor did this legislative usage exist in the periods preceding the judicial U-turn occurred in 1999 (…).'[60]

Additionally, the interpretation which the Italian judiciary applied to the compound interest clause, existing until 1999,[61] 'inclined to affirm the legitimacy of these clauses, was not enough to render legislative a usage that resulted in be-

[59]Italian Supreme Court, Plenary Meeting, 4 November 2004, no 21095.
[60]Italian Supreme Court, Plenary Meeting, 4 November 2004, no 21095. Our translation.
[61]Before the 1999 U-turn, the Italian Supreme Court was quite well disposed to affirm the validity of compound interest clauses. See Italian Supreme Court, 15 December 1981, no 6631; Italian Supreme court, 19 August 1983, no 5409; Italian Supreme Court, 6 June 1988, no 3804.

ing against the law too.'[62]

A further complication subsequent to the CICR decree was the decision of the Italian Constitutional Court, relating to the Legislative Decree 4 August 1999, no 342. Art 25(3) of this decree stipulated that the compound interest clauses existing in contracts before its coming into force ought to have been regarded as converted into valid terms. As a result, art 7 of the CICR decree arranged for a period during which the capitalisation clauses should have been amended in order to bring alignment to the new provisions. However, the Italian Constitutional Court unexpectedly declared such legal provisions (art 25, Legislative decree no 342 and its implementing norm within the CIRC decree) to be invalid.[63] The Government, in passing the legislative decree, had exceeded the mandate given to it by Parliament.

This legislative novelty *de facto* legalised the practice of the compound interest in Italy, and - possibly - overturned the judicial stances of the controversial double Supreme Court *dicta*. However, it was held that the accrual of the compound interest ought to have been calculated according to the same rest or timeframe, for the same transaction, particularly in relation to bank accounts. The rest on which the compound interest was required to be determined would be symmetric and identical for the same bank account. Previous banking practices where banks would traditionally calculate active compound interest[64] every quarter, and passive compound interest[65] every year, became unlawful. This reform of art 120(2) remained unaffected by a following amendment, passed in 2010.[66] In essence, in the period spanning the years of 1999 and 2013, the practice of charging

[62]Ibid, our translation.
[63]Italian Constitutional Court, 17 October 2000, no 462.
[64]Therefore, interest owed by the bank to the client eg because of an overdraft.
[65]Therefore, interest owed to the client by the bank eg because of a balance in favour of the client above zero.
[66]The reform is courtesy of article 4 of Legislative Decree 13 August 2010, no 141, as amended by art 3(3), Legislative Decree 14 December 2010, no 218, effective as from 2 January 2011. See MANZI, *Commentary to Art 120*. in F Capriglione (ed), *Commentario al Testo Unico delle Leggi in Materia Bancaria e Creditizia III* (n 58) 1746-1761.

compound interest, which had been seriously challenged by the decisions of the Italian Supreme Court in 1999, was officially legalised in Italy - whether or not this has given rise to any retrospective consequences is still open to debate,[67] given the decision of invalidity of the Italian Constitution Court[68] - subject to specific conditions. As correctly acknowledged on a doctrinal level:[69]

'As far as the legislation is concerned, the only limit established by the Italian Banking Consolidated Act [was] the compliance with the equal treatment between active and passive interest, which [would] be applicable in an imperative way according to the same rest.'[70]

However, the rather fractured stance on compound interest in Italy had not yet concluded, and the tenor of art 120, ICBA has been further altered as a result of a new reform, which came into force later in 2013.[71] Charges related to compound interest are no longer permitted in the light of the amended article 120(2) of the IBCA. This legal provision stipulates that the *Comitato Interministeriale per il Credito ed il Risparmio* establishes modalities and criteria in the way the interest relating to transactions carried out in the performance of the banking business will accrue.[72] Yet there is a significant departure from customary practice, that is to

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[67]Italian Supreme Court, Plenary Meeting, 2 December 2010, no 24418) has held more recently that, in cases where the quarter compound interest clause is null, the fall-back applicability of the yearly compound interest clause shall be ruled out, as there was no usage, nor any practice, of yearly capitalisation for periods preceding the 1999 *decisa*.
[68]See above under this Section 4.3.
[69]See MIRONE, *Commentary to art 120*, in Costa (ed), *Commento al Testo Unico delle Leggi in Materia Bancaria e Creditizia II* (G Giappichelli, Turin 2013) 1372.
[70]Our translation.
[71]More specifically, this is the outcome of article 1(629) of Law 27 December 2013, no 147, in force as from 1st January 2014. For commentaries to this new piece of legislation, see STILO, *Dall'art. 120, comma 2, TUB alla Proposta di Delibera CICR: verso il Ritorno dell'Anatocismo Bancario*, [2015] *Rivista di Diritto Bancario*, 1-23. Se also TOLA, *Anatocismo e Conto Corrente Bancario nel Diverso Approccio alla Giustizia*, (2016)69 *Banca Borsa e Titoli di Credito* 327-340.The latter autor discusses both a court decision (Cagliari Tribunal, 20th May 2015) and a decision of the Italian Banking Financial Ombudsman (8th October 2015, no 7854).
[72] As far as commentaries on the draft of this new CICR decree are concerned, see in the recent literature FIORIO, *Il Divieto di Anatocismo a la Nuova Disciplina degli interessi Bancari. Prime Osservazioni alla Bozza di Deliberazione CICR*, (2015) Il Caso, 26 October 2015 http://www.ilcaso. it/articoli/ban.php?id_cont=833.php> accessed 29 October 2015.

say, it will be mandatory that the interest capitalised upon every rest shall not give rise to further interest and that any interest (whether compensatory or penal) shall be calculated exclusively on the simple capital, without any addition of interest.[73] The tenor of the amended art 120(2) is worthy of a recollection:

'The CICR established modalities and criteria for the accrual of interest in the transactions carried out in the performance of the banking activity, provided that in any case:

(a) In the bank account transaction it is warranted that, vis-à-vis the clientele, both the active and passive interest shall be calculated according to the same rest;

(b) The interest capitalised with periodicity shall not give rise to further interest that, in the following operations of capitalisation, are calculated exclusively on the capital'.

Essentially, the norm seems to have administered the last rites to compound interest in Italy, although some interpretations still remain unclear as to how this new legal provision affects existing transactions concluded prior to the new legislation coming into force.[74] In this respect, the very recent *decisa* available[75] seem to suggest that the prohibition of compound interest does apply to the past, and therefore the amended art 120(2) of the ICBA is retrospective, although objections to this interpretation are voiced by other sides of the same Italian judiciary.[76]

Given the serpentine development of the Italian legislation in this area too, it would not be overly speculative to predict future episodes in this never-ending series, laden with twists in the narrative and fluctuating outcomes. Curiosity killed

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At the time of the writing of this contribution, the official CICR decree implementing the new version of article 120 of the TUB has not been passed yet.

[73]Our translation.

[74]See TORRENTE and SCHLESINGER (n 51) 405.

[75]Among the few *decisa*, see Rome Tribunal, 20 October 2015; Milan Tribunal, 29 July 2015.

[76]See the very recent Bologna Tribunal, 7 December 2015, where it is stated that the new amended version of art 120(2), prohibiting the compound interest, cannot be regarded as in force, so long as the secondary legislation (*ergo*, the CICR decree) has not been passed.

the cat! Law no 49 of 8th April 2016 entered into force on 15th April 2016, further amending art 120, paragraph 2 of the ICBA, in force of art 17bis.[77]

The amendments are threefold.

First, the CICR is empowered to fix 'criteria and modalities for the calculation' of any interest, including the simple one. By contrast, in the past, this entitlement related exclusively to the compound interest. Furthermore, this power of the CICR is concerned with any kind of lending activities put in place by the bank, not necessarily bank account transactions.

Second, from an accounting point of observation, the new legal provision, particularly art 120(2)(b), stipulates that the interest accrued on either bank accounts or any other contractual relationship settled via a bank account,[78] be calculated according to the same rest, both if this interest is owed to the bank or against it. In this respect, the legal provision fundamentally reinforces the rule encompassed with the previous correspondent art 120(2)(a) of the 2013 TUB version, already referred to above. However, it is also expressly stipulated that the interest shall be calculated every year upon expiry of the 31st December and in any case when, upon expiry of the transactions, the interest is due.[79]

Third, art 120(2)(b) of the TUB substantially confirms the prohibition of compound interest for any sum owed by the debtor,[80] including the interest accrued on credit card loans. In these cases the interest shall be calculated exclusively on the capital However, the exception is the default interest which, if compounded, seems to be (again) valid in Italy, based on the very recent piece of leg-

[77]Law no 49/2016 converted Law Decree 14th February 2016, no 18. It is worth noting that an initial attempt to reinstate the compound interest after the 2013 reform was Law Decree 24th June 2014, no 91, art 31. However, this interim norm, encompassed with a piece of legislation passed by the Italian Government, was not later converted in law by the Italian Parliament.

[78]It is argued doctrinally (FARINA, *La (Ennesima) Resurrezione dell'Anatocismo Bancario* [2016] *I Contratti*, 707) that the terminology adopted in the new framework (*rapporti di conto corrente o di conto di pagamento*, therefore current account o payment account transactions), albeit formally different from the 2013 counterpart (*operazioni in conto corrente*, therefore current account operations), does not substantially change the scenario, nor does it warrant different legal stances.

[79]New art 120(2)(a), second part.

[80]The wording is so vast that the expression seems to be applicable to any bank transaction which, theoretically, may give rise to debt interest owed by the customer to the bank. FARINA (n 78) 709.

islation . Nevertheless, the legal provision under discussion caters for a further option. Namely, the customer may authorize, also before the currency of the bank account, the debit of the interest on his/her bank account, therefore on the capital, where this interest is due, as far as three main transactions are concerned: bank accounts; revolving credit cards; credit openings; overdraft bank accounts. However, in order to partly protect the customer, for these transactions, it is also expressly stipulated that the interest shall be calculated every year upon expiry of the 31st December, and made due on 1st March of the following year, or the year when there accrue.[81] Ultimately, it is possible to infer that compound interest is again legal in Italy, particularly if this is a default interest. However, as regards compensatory interest, the validity is not the automatic outcome of the contract, enforced by the bank, rather a deliberate choice of the customer and it concerns exclusively some bank transaction. According to the legislative novelty, this choice can be revoked by the client until the bank account has been debited.

In light of the absolute novelty of this body of law, no *decisa* appear to have been issued. From an interpretive point of view, it is possible to briefly mention that the choice about whether compound interest is permitted or not, as left to the party autonomy, may leave room for numerous and uncertain judicial outcomes. Seemingly, the judiciary will be asked to assess whether consent has been given according to the orthodox cannons of contractual diligence. Bearing this in mind, it is possible to figure out legal claims by clients aimed to invalidate the compound interest clause. Needless to say, this may pave way for uncertainties and dubieties about the further judicial stances. Doctrinally, it is also emphasised that the new legal provision, with its partial opening to the compound interest, can be explained through a political *fil rouge*: the current Italian Government, concerned about the huge losses recorded by its credit institutions in the last years,

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[81] Nevertheless, in case of final termination of the transaction, the interest shall be immediately due. See new art 120(2)(b)(1).

has simply decided to indirectly help the domestic banking system as a whole.[82]

Apart for the legislative developments and twists occurred in Italy in the last decades, it is worth mentioning that a different, albeit marginal, school of thought in Italy is inclined to affirm that the capitalisation of the interest is a phenomenon not ascribable to the compound interest usage as legislated and, ultimately, prohibited under art 1283, ICC. With a reasoning that may be similar to what historically has been suggested by the British courts, the quarterly annotation of the compensatory interest on the bank account is tantamount to a payment by the client of that capital plus the interest, with the termination of the balance and re-loan of the balance plus the interest. Accordingly, the future interest shall be permissible as it is calculated on the re-lent money, although this comprises of the capital plus the interest.[83]

5. The British common law has recognised compound interest in an almost tangential manner in order to bypass, with an accounting artifice, the prohibition of usury laws. The anti-usury *corpus iuris* had been introduced in Britain as early as the Renaissance period and had been scrapped by the middle of the 19th century. Yet the abolishment in the contemporary era of the usury has not engendered a crisis of the concept of anatocism, which has persevered and, to a certain extent, flourished until recently. However, this contribution, in diverging from the traditional critique, unearths and hopefully demonstrates that the lawfulness of the practice of the compound interest in Britain is a comparatively recent phenomenon, courtesy of the 'Pinios' case. Conversely, a critical discussion of previous case law, specifically those of the 20th and 21st centuries, reveals that the compound interest in the British common law was merely tolerated in the past, and exclusively

[82]See TOLA (n 71) 340. For a historical analysis of the compound interest in Italy, see the very recent TAVORMINA, *Anatocismo e Frutti Civili da Napoleone ai Nostri Esegeti* (forthcoming).

[83]See MORERA, *Sulla non Configurabilità della Fattispecie "Anatocismo" nel Conto Corrente Bancario*, [2005] *Rivista di Diritto Civile* 17-25; FERRO-LUZZI, *Una Nuova Fattispecie Giurisprudenziale: "l'Anatocismo Bancario": Postulati e Conseguenze,* (2001)28 *Giurisprudenza Commerciale* 5-34.

in relation to mercantile bank account transactions. Ultimately, the Pinios case should be read in a more revolutionary way that scholars have not done so far.

Furthermore, given the distinct lack of an *ad hoc* piece of legislation in this area, which conversely has flourished in the civil law systems of comparators, Britain offers a limited form of protection to the bank customer via the legislation aimed to protect the general consumer. As highlighted by this paper, the way in which the legislation is worded makes it a particularly arduous task to ascertain whether the bank customer enjoys an easy and effectual form of protection. As a result of this, the British bank customer, in tackling the phenomenon of the compound interest, shall merely rely on the benevolence of the banks and on the precarious rules of a 'code', issued by the credit institutions and credit card providers, that encourages - but does not oblige - the provider to be as explicit and transparent as possible in disseminating the manner in which the interest is calculated. Notwithstanding this, the contribution criticises this *modus operandi* for two main reasons: (a) it does not offer a judicial protection to the customer, as it is not made explicit; (b) with dubious transparency, the existing code does not explicitly acknowledge compound interest, but merely implies that the concept has been considered, requiring the banks to clarify to the public the way in which any interest rate is calculated.

Additionally, from a comparative perspective, this contribution castigates the Italian approach to compound interest. The unfettered and, at times, obsessive protection of the weaker party (ie the bank customer) pursued in that country in the *sedes materiae* of banking law, where the compound interest has even been rendered illegal courtesy of an unexpected 2013 legal framework, may represent a Pyrrhic victory for the customers and induce a quickly curtailed bout of scaremongering amongst the service providers, the banks. The reaction of the latter, in the long term, will be to either increase the costs of their services or to engage in an impromptu exodus from that national market. In this respect, the continuous changes in legislation and judicial twists over the concept of *anatocimo*, recorded in Italy over the past two decades, would appear to suggest that the matter has now transcended a purely legal battleground. The discussions on the compound interest in that country appear to echo the medieval battles of Guelphs and Ghibellines and, therefore, the tensions between two different factions, rather than the logical development of the legal tradition of that country.

Moreover, from a 'law and economics' viewpoint, it can be affirmed that within Italian law the continuous changes and amendments to the legislation no longer afford certainty; ultimately, this may estrange the investors in a medium-long term perspective. Conversely, the common law, hinged upon its entrenched precedents, more recently accompanied by the soft law, caters for a more stable 'stage' where the evolution of the rules (either cogent or not) is more balanced and the approach more market-friendly.[84]

Also, in relation to both the British common law and the Italian comparator, a possible criticism may arise from this paper. A more careful analysis of the ancestor, the Roman law, and its clear distinction between *futurarum usurarum usurae* and *usurarum usurae*, might have lent itself to the discovery of a helpful epistemological method in order to strike a middle ground between diametrically opposing, and not entirely justified, stances in the area of the anatocism.[85] More specifically, the British common law, in drawing on this distinction, could have re-

[84]On the entrenched differences between common law and civil law, particularly as regards the rules of interpretation, see G Carney, 'Comparative Approaches to Statutory Interpretation in Civil Law and Common Law Jurisdictions' (2015)36 Statute Law Review 46-58. More in general, as regards the traditional differences between *common law* and *civil law* and their missing inter-communication, see LEGRAND, *European Legal Systems Are Not Converging*, (1996)45 *The International and Comparative Law Quarterly* 52-81. For a methodological study on comparative law, see SIEMS, *Comparative Law* (Cambridge University Press, Cambridge 2015).

[85]In the British common law, the possible connection between the modern phenomenon of compound interest and the *anatocism* does not seem to have been even highlighted. In the Italian literature, a scholar (BELVEDERE, *Anatocismo Bancario e "Usi Contrari"* , in MV De Giorgi, S Delle Monache e G De Cristofaro (eds), *Studi in Onore di Giorgio Cia*n (CEDAM, Padua 2010) 156-199, particularly 198), without entering the details of the Roman ancestor, seems to suggest that a better historical analysis was required in order to solve the private law debate about the legality of the compound interest in that country.

garded as lawful exclusively the compounding of the interest already due.[86] As far as the Italian jurisdiction is concerned, the piece of legislation enacted in 2013, whereby any form of compound interest has been declared illegal, regardless of whether or not the interest is due, should have been better considered. It goes without saying that this certainly would have occurred, had the Roman archetype been afforded due contemplation.

Finally, the comparison between the two countries (Italy and England) shows a significant difference in the way the legislature protects the bank customer as regards the compound interest. Intriguingly, a new legal framework at an EU level could be promoted in order to protect the bank customer in this niche area of private law. Paradoxically, though, the country (Britain) where this protection is needed could get away with this as after the Brexit this prospective EU legislation would no longer apply across the Channel. Are the Brexit and the compound interest in Britain a mere coincidence?

[86] Whereas, as highlighted under the Section 3 above, traditionally common law regards as lawful any kind of compound interest.