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The Global Reach of EU Law Through the Regulation of Third-country CRAs and CCPs in the EU

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ABSTRACT

Financial markets operate on a global scale, characterized by complex interactions and rapid changes. In the European Union (EU), cross-border financial services have introduced complexity, particularly with the participation of third-country providers. In this regard, the EU has endeavored to establish a regulatory framework that both bolsters its single financial market and aligns with international standards post-financial crises. This research explores the post-crisis regulatory frameworks governing third-country Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) in the EU, with a focus on the extraterritorial implications of EU law instruments, such as endorsement and equivalence. Through a conceptual and legal framework, it will analyze how these instruments influence third-country CRAs and CCPs' legislation. To illustrate this impact, it will examine case studies of Australian CRAs and UK CCPs. This comprehensive study highlights the significance of EU financial regulations beyond its borders, offering valuable insights into the global financial landscape.

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LIST OF ABBREVIATIONS

AA	Association Agreement
ACRA	A’s Credit Rating Agency
AFS	Australian Financial Services
AIFMD	Alternative Investment Fund Managers Directive
AIFs	Alternative Investment Funds
APRA	Australian Prudential Regulation
ASEAN	Association of South East Asian Nations
ASIC	Australian Securities and Investment Commission
BCBS	Basel Committee of Banking Supervision
BIS	Bank for International Settlements
C6	Committee 6
CBI	Central Banks of Issue
CCPs	Central Counterparties
CESR	Committee of European Securities Regulators
CETA	Comprehensive Economic and Trade Agreement
CFTAs	Comprehensive free trade agreements
CFTC	Commodity Futures Trading Commission
CGFS	Committee on the Global Financial System
CJEU	Court of Justice of the European Justice
CMU	Capital Markets Union
CPMI	Committee on Payments and Market Infrastructures
CPSS	Committee on Payment and Settlement Systems
CRAs	Credit Rating Agencies
CRD IV	Capital Requirements Directive IV
CRDs	Capital Requirement Directives
CRR	Capital Requirements Regulation
CSDs	Central Securities Depositories
DBRS	Dominion Bond Rating Service
DCFTA	Deep and Comprehensive Free Trade Area
DVP	Delivery Versus Payment
EACCH	European Association of Counterparty Clearing Houses
EACH	European Association of Central Counterparty Clearing Houses
EBA	European Banking Authority
ECAI	External Credit Assessment Institution
ECB	European Central Bank
ECJ	Court of Justice of the European Union
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority

EMIR	European Market Infrastructure Regulation
ENP	European Neighborhood Policy
ESA	European Supervisory Authority
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ET	Exchange Traded
EU	European Union
FC	Financial Counterparty
FMIs	Financial market infrastructures
FMRD	Financial Markets Regulatory Dialogue
FSAP	Financial Services Action Plan
FSB	Financial Stability Board
FSF	Financial Stability Forum
FTA	Free Trade Agreements
G20	Group of 20
GATS	General Agreement on Trade in Services
GDPR	General Data Protection Regulation
GEM	Global Economy Meeting
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICJ	International Court of Justice
ILO	International Labour Organization Convention
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
MAS	Market Access Strategy
MiFID	Markets in Financial Instruments Directive
MiFIR	Markets in Financial Instruments Regulation
MMoU	Multilateral Memorandum of Understanding
MoU	Memorandum of Understanding
NCAs	National Competent Authorities
NFCs	Non Financial Counterparties
NRSROs	Nationally Recognized Statistical Rating Organizations
OECD	Organization for Economic Cooperation and Development
OTC	Over the Counter
PBR	Principles-Based Regulation
PFMI	Principles for Financial Market Infrastructures
PSG	Policy Standing Group
RSSS	Recommendations for Securities Settlement Systems

SAA	Stabilization and association agreements
SEC	Securities and Exchange Commission
SFTs	Securities financing transactions
SRs	Securitization Repositories
TCA	Trade and Cooperation Agreement
TC-CCPs	Third Country-Central Counterparties
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
TiSA	Trade in Services Agreement
TRs	Trade Repositories
TTIP	Transatlantic Trade and Investment Partnership
UCITS	Undertakings for Collective Investment in Transferable Securities
UN	United Nations
US	United States
WTO	World Trade Organization

CHAPTER I: INTRODUCTION

1 Introduction

Financial markets are characterized by their global nature, intricate interconnections, and constant rapid changes.[1] In the European Union (EU), the development of cross-border financial services has been particularly challenging and the participation of providers from third countries have added another layer of complexity. Nevertheless, the EU has sought to develop a regulatory framework that reinforces the single market in financial services, following the financial crises that impacted the region. These rules serve a dual purpose: on one hand, they seek to strike a delicate balance between ensuring financial stability and safeguarding investors within the EU. On the other hand, they aim to leverage the benefits of maintaining open and globally integrated EU financial markets.[2] Additionally, these regulations play a crucial role in promoting convergence with international standards in regulatory practices and act as a pivotal driver in fostering supervisory cooperation with relevant third-country partners.[3]

This dissertation will undertake a comprehensive analysis of the post-crisis legal frameworks governing third-country Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) in the EU. It will investigate how these regulatory measures can have far-reaching effects on the internal laws concerning CRAs and CCPs in the third countries involved, as well as their impact on global standards. In particular, this study aims

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[1] Gudula Deipenbrock, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies-Some Critical Observations in a Broader Context' (2018) 29 European Business Law Review 169.

[2] Lucia Quaglia, 'Financial Regulation and Supervision in the European Union after the Crisis' (2013) 16 Journal of Economic Policy Reform 17.

[3] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final'.

to shed light on the potential extraterritorial implications of two EU law instruments used to permit the operation of third-country CRAs and CCPs within the EU: endorsement and equivalence.[4] To achieve this goal, the dissertation will closely analyze the regulatory tools employed by the EU to regulate these services, with a specific focus on how they allow third-country ratings for regulatory purposes and the clearing of Over the Counter (OTC) derivatives by third-country CCPs in the EU. By exploring these aspects, the research seeks to gain a comprehensive understanding of the effects of EU regulations on third-countries.

This dissertation focus on two crucial financial services: CRAs and CCPs, mainly due to their significant roles in the 2008 financial crisis. CRAs faced heavy criticism for their lack of regulation, which was deemed a contributing factor to the crisis, while CCPs emerged as saviors for their ability to prevent further disruptions. In the aftermath of the crisis, noteworthy regulatory changes have been implemented for CRAs at both the EU and international levels, exemplified by Regulation (EU) 1060/2009 on CRAs (CRA Regulation I) and the latest version of The IOSCO Code of Conduct in 2015, aimed at improving its operations and correcting previous mistakes such as, the issuer-pays model, lack of competition, and mandatory reliance on ratings.

Regarding CCP regulation, there has been a significant increase in efforts both at the EU and international levels to enhance oversight and safeguard against future crises. The European Market Infrastructure Regulation (EMIR) and the IOSCO Principles for Financial Market Infrastructures are prime examples of the proactive measures taken to

[4] This research will also delve into the concept of Comparable Compliance, considering it as a complementary facet to equivalence rather than a distinct instrument. However, it is important to note that the term itself is relatively new and subject to potential future modifications.

strengthen CCP regulation and ensure the stability of financial markets.[5] These regulatory initiatives aim to foster greater transparency, risk management, and resilience in the financial system, mitigating potential risks and bolstering confidence in the clearing and settlement of financial transactions.

However, the most intriguing and noteworthy regulatory changes regarding third-country CRAs and CCPs in EU regulation are the concepts of equivalence and endorsement. These instruments demand third countries' regulatory and supervisory standards to be "equivalent" or "as stringent as" those of the EU concerning one financial service in order to enable these services to function within the EU's jurisdiction.[6] In essence, equivalence and endorsement act as gateways, enabling third-country entities to access the EU market only if they meet comparable regulatory and supervisory requirements.

The implementation of these two instruments, equivalence, and endorsement, involves a complex interaction of regulatory officials beyond the field of EU financial law. It navigates other domains, including external relations law and international trade law. Consequently, the regulation of market access for third-country CRAs and CCPs has been crafted within EU law, incorporating a multitude of standards, ad-hoc procedures and diverse types of rules. Consequently, identifying the precise approach taken by the EU towards regulating this interaction poses a challenge, primarily due to the divergent rules that exist for different financial services and third countries involved and also because

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[5] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation); Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies (March 2015) FR05/2015'.

[6] European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR (18 July 2018) ESMA33-9-24'.

the complexity arising from the multitude of standards and guidelines concerning equivalence and endorsement can make it challenging to grasp their exact workings.

As a result, gaining a comprehensive insight into the functioning of these mechanisms becomes crucial in order to navigate the difficulties of their regulation and effectively analyze their impact on third countries and international standards. Such an analysis is critical as the interrelation between the EU and third countries in this field can significantly impact the EU's role as an international actor and standards setter concerning CRAs and CCPs.

For these reasons, this dissertation will argue that the EU holds the potential to impact the regulation of CRAs and CCPs in third countries and on the global stage through provisions with extraterritorial reach. These provisions encompass the rules governing the access of third-country CRAs and CCPs to the EU single market, such as, endorsement and equivalence.

To support this argument, the dissertation will first present a conceptual framework to understand the field, then it will develop a legal framework, first by explaining how financial regulation of CRAs and CCPs works globally and in the EU. Then, it will explain the importance of the concept of third country in the field of financial services in the EU. Later it will explain how a possible extraterritorial reach of third-country CRAs and CCPs regulation takes place. Then, it will illustrate that information through two examples, one of equivalence and endorsement of Australian CRAs and another of equivalence of a UK CCPs.

To support the argument, this dissertation will lay the groundwork by presenting a comprehensive conceptual framework that aids in understanding the particulars of the CRAs and CCPs. Subsequently, it will delve into the legal framework, beginning with a detailed exploration of the global and EU-specific financial regulation concerning CRAs and CCPs.

The significance of the concept of "third country" in the EU's financial services, with a particular focus on CRAs and CCPs will be elaborated upon, shedding light on its implications for the regulatory landscape. Moreover, this study will place a special emphasis on uncovering and understanding the potential extraterritorial impact of the EU's regulatory and supervisory framework on CRAs and CCPs. To demonstrate the practical application of this concept, two exemplary case studies will be presented: one studying the equivalence and endorsement of Australian CRAs, and the other analyzing the equivalence of UK CCPs. These examples will serve to illustrate how EU regulations interact with third-country financial services providers, showcasing the implications of these interactions on a global scale.

By using a systematic approach that encompasses conceptual, legal, and practical perspectives, this dissertation aims to provide a comprehensive understanding of the impact of EU rules on third-country CRAs and CCPs regulation, while also highlighting their broader significance for international financial systems.

2 The Research Question

This dissertation endeavors to provide comprehensive insights into the regulatory impact of EU law on the regulation and supervision of CRAs and CCPs in third countries, focusing on the instruments used for accessing the EU single market. The main research question guiding this study is: How do the post-crisis regulatory instruments established by the EU to enable third-country CRAs and CCPs to access the single market influence the regulation of these financial services in third countries and internationally, and to what extent do these provisions exhibit global reach?

To address this overarching question effectively, two auxiliary questions will be explored: Firstly, how do the regulatory instruments used by the

EU to grant access to third-country CRAs and CCPs work? Through this question, an examination of the instruments available to CRAs and CCPs for accessing the EU will be conducted to understand their workings. Secondly, does EU law exhibit any global reach in the provisions ruling the instruments designed for enabling third-country CRAs and CCPs' access to the single market? By exploring the global reach of EU law in these provisions, the study aims to understand the impact of EU regulations on third countries and assess how they interact with global financial standards.

3 Scope of the Study

The scope of this study is to examine the regulatory impact of EU law on third countries and international standards concerning CRAs and CCPs' regulation. The research will specifically focus on the provisions governing the instruments established by the EU, namely equivalence and endorsement, which permit Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) from third countries to operate within the EU's jurisdiction. By analyzing these regulatory mechanisms, the study aims to uncover their impact on the regulation of CRAs and CCPs in third countries and assess the extent of their extraterritorial reach.

The scope of the study is limited to the examination of the regulatory aspects and challenges pertaining to CRAs and CCPs within the EU. It does not encompass a comprehensive analysis of all aspects related to financial regulation or other financial services beyond CRAs and CCPs. The study aims to contribute to the existing body of knowledge on financial services regulation, with a specific focus on these two services and their implications. Furthermore, the study will specifically delve into the realm of ratings for regulatory purposes, examining their implications for third-country CRAs with regulatory purposes, and will exclusively concentrate

on Central Counterparties (CCPs) that engage in clearing Over The Counter (OTC) derivatives.

This research also aims to shed light on the legal aspects of financial regulation concerning CRAs and CCPs operating across borders, as much of the existing literature is predominantly authored by economists. It is essential to address this gap since some experts argue that the 2007 financial crisis was more of a legal failure than an economic one.[7] Surprisingly, the scholarly focus on this matter continues to be largely economic rather than legal. Therefore, this dissertation endeavors to contribute to the development of legal scholarship on financial regulation, with a particular emphasis on cross-border operations of CRAs and CCPs.

4 The selected measures to allow access from third countries providers of financial services to the EU internal market. The case of the Credit Rating Agencies (CRA) and the Central Counterparties (CCP)

This research will exclusively focus on two key measures that pertain to the access of third-country CRAs and CCPs to the EU single market, namely equivalence and endorsement for CRAs, and equivalence for CCPs. The choice to exclude trade agreements from this study is based on two fundamental reasons: Firstly, trade agreements often contain general provisions regarding financial services, lacking specific explanations on how a particular financial service can access the EU market or vice versa. Moreover, even in countries with trade agreements, the EU has opted to apply endorsement and equivalence for selected financial services. For instance, it is worth noting that even under the Comprehensive Economic and Trade Agreement (CETA) which includes a

[7] Lynn A Stout, 'How Deregulating Derivatives Led to Disaster , and Why Re -Regulating' [2009] Cornell Law Faculty Publications 1; Colleen M Baker, 'Regulating the Invisible: The Case of over-the-Counter Derivatives' (2010) 85 Notre Dame Law Review 1287.

chapter on financial services, Canadian CRAs are still required to apply for equivalence or endorsement in order to access the EU single market. This exemplifies how even with trade agreements in place, the use of equivalence and endorsement remains necessary for third-country CRAs to operate within the EU jurisdiction. Secondly, since the primary objective of this research is to assess the impact of these instruments on the regulation of CRAs and CCPs in third countries, trade agreements do not align with this purpose. Instead, the study will explore cooperation agreements, which present one of the conditions for equivalence and endorsement. Consequently, this dissertation will solely concentrate on equivalence and endorsement as the chosen measures for investigation.

4.1 Equivalence

An equivalence decision entails a unilateral assessment conducted by the EU, evaluating third countries' regulatory, supervisory, and enforcement regimes related to specific financial services. The purpose is to determine whether these regimes align with EU standards and are comparable in their effectiveness.[8]

These decisions can be applied in different fields. If the regimes are deemed equivalent by the European Commission, the third country's participants are temporarily or indefinitely authorized to operate, partially or fully, in the internal market.[9] These decisions take the legal form of an implemented or delegated act signed by the institution in charge of executing this task.[10]

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[8] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment' (n 3).

[9] ibid.

[10] Alienor Anne Claire Duvillet-Margerit, Benoit Mesnard and Marcel Magnus, 'Third Country Equivalence in EU Banking Legislation. European Parliament. Briefing' (*European Parliament-Economic Governance Support Unit DG Internal Policies Briefing*, 2017), 4.

There are two different systems for making an equivalence decision depending on the institution in charge. In the first method, the decision is taken by the European Commission, and its conclusion acts as a source for certain authorizations or approvals.[11] In some of these procedures, the European Commission has support from a European Supervisory Authority (ESA). In the second method, on the other hand, an ESA, namely, the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA), or the European Insurance and Occupational Pensions Authority (EIOPA), has full control of the decision-making process and its conclusion concerns a specific subject.[12]

In order to provide a clearer understanding of the issue at hand, this dissertation will classify equivalence decisions as positive decisions when the EU determines that the supervisory and regulatory regime of a third country is equivalent. Conversely, negative decisions will be referred to when the EU finds the systems of the third country to be non-equivalent or when the EU revokes a previously approved equivalence decision.

4.2 Endorsement

This instrument holds particular relevance for this research as it directly pertains to a specific financial service within the study's scope: CRAs. Under this system, third-country-based CRAs are required to meet specific legal conditions that are "as stringent as" the EU's regulatory requirements.[13] This ensures that CRAs from third countries must adhere to high standards comparable to those imposed on CRAs within the EU.

[11] Eddy Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (2018) 4 Journal of Financial Regulation 209, 218.
[12] ibid, 218.
[13] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282'.

The ESMA is also responsible for this procedure. This authority establishes a list of third countries which have regulations "as stringent as" the EU rules.[14]

5 The selected financial services provided by third countries: Credit Rating Agencies (CRAs) and the Central Counterparties (CCP)

Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) were selected as the focal point of this research due to their significant roles and relevance in the aftermath of the global financial crisis. The crisis shed light on the crucial need for effective regulation and supervision of financial services, and both CRAs and CCPs were at the center of attention.

These two financial services share several important aspects that make them particularly relevant for this study. One such aspect is the potential extraterritorial reach of their regulation. As global entities, CRAs and CCPs often operate across borders and interact with multiple jurisdictions. As such, their activities can have implications beyond their home countries, requiring cooperation and coordination among global financial regulators. This raises questions about the impact of EU regulatory measures on these services in third countries.

On the other hand, CCPs and CRAs play a vital role in managing risks in financial transactions, both are subject to are subject to financial regulations aimed at ensuring transparency, stability, and investor protection and both have a direct impact on financial stability. For instance, both CRAs and CCPs are obliged to comply with the

[14] European Securities and Markets Authorities (ESMA), CRA Authorisation, available at: <https://www.esma.europa.eu/supervision/credit-rating-agencies/risk> accessed 30 August 2023.

requirements of the Capital Requirements Regulation (CRR). This regulatory framework sets specific standards and rules that both CRAs and CCPs must adhere to in order to ensure financial stability and the sound functioning of the markets. Indeed, the European Securities and Markets Authority (ESMA) plays a crucial role in the regulation and supervision of both CCPs and CRAs within the EU.

5.1 Credit Rating Agencies (CRAs) in the EU

The regulation of CRAs in the EU underwent a significant transformation in 2009 when the CRA Regulation I was introduced. Since then, the regulatory landscape for CRAs has evolved with the implementation of subsequent amendments and updates to the regulation. Currently, CRAs operating in the EU are governed by this comprehensive framework, which continues to be refined to address new challenges and ensure the effectiveness of oversight. This regulatory framework enables the admission of third-country CRAs' ratings into the EU's financial markets, making them applicable for regulatory purposes among other uses.[15]

This recognition of third-country CRAs' ratings for regulatory purposes within the EU is facilitated through two distinct systems. The first mechanism is known as an "equivalence certification" which involves a certification granted by the European Securities and Markets Authority (ESMA) upon direct request by the CRA in question.[16]

The second method is known as endorsement, a mechanism that allows third-country-based CRAs to have their ratings recognized and accepted

[15] European Securities and Markets Authority (ESMA), 'Final Report Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR' (n 6).

[16] Deipenbrock, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies-Some Critical Observations in a Broader Context' (n 1), 195.

within the EU market. However, for endorsement to take place, these CRAs must adhere to specific legal conditions that are just "as stringent as" the regulatory requirements set forth by the EU.[17] The ESMA, as the competent authority, maintains and updates a list of third countries whose regulatory and supervisory frameworks for CRAs are deemed to be "as stringent as" those set forth by the EU. This list serves as a key reference point for market participants and stakeholders, providing clarity on which third-country CRAs are eligible for endorsement within the EU.[18] The endorsement mechanism is solely applicable to CRAs seeking access to the EU market.

5.2 Central Counterparties (CCPs) in the EU

The legal framework governing CCPs in the EU has evolved through various directives and regulations, with EMIR being the cornerstone of this regulatory regime.[19]

EMIR, introduced in 2012, stands as the principal regulatory instrument specifically addressing CCPs and the clearing of over-the-counter (OTC) derivative contracts within the EU. It was a crucial response to the financial crisis, aimed at enhancing transparency, mitigating risks, and promoting stability in the financial system. EMIR also included provisions regarding the recognition of third-country CCPs, permitting them to provide clearing services within the EU if they meet the necessary requirements, including those related to equivalence and regulatory supervision. This recognition ensures that non-EU CCPs adhere to standards equivalent to those set by the EU. Furthermore, the process of recognition for CCPs involves a direct application by the CCP seeking

[17] ibid.
[18] European Securities and Markets Authorities (ESMA), CRA Authorisation (n 14).
[19] EMIR Regulation (n 5).

recognition. Once the recognition is granted by the ESMA, third-country CCPs gain the privilege of being utilized by EU market participants for clearing over-the-counter (OTC) derivatives or reporting transactions.

6 Countries selected for the study: Australia and the UK

Financial services associated with third countries in the EU possess distinctive characteristics and risks, which add complexity to their regulation.[20] Notably, the geographical location of service providers and the potential for crises to rapidly spread from abroad amplify the complexities in regulating these services. These complexities arise due to variations in legal frameworks, supervisory practices, and market dynamics across different jurisdictions.[21]

As a result, effectively regulating and supervising these cross-border financial activities require comprehensive understanding and cooperation among relevant authorities.[22] Furthermore, the interconnectedness of global financial markets necessitates careful consideration of potential spillover effects and the implications of regulatory decisions on a global scale.[23] Striking the right balance between promoting international financial integration and mitigating risks requires continuous coordination and harmonization efforts among regulatory bodies worldwide.

In the particular case of CRAs and CCPs, effective regulation and supervision of these activities hold utmost importance. The critical role

[20] Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (Oxford University Press 2009).
[21] Matthias Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (2019) 45 EBI Working Paper Series.
[22] Niamh Moloney, 'Financial Services and Markets' in Robert Baldwin, Martin Cave and Martin Lodge (eds), *The Oxford Handbook of Regulation* (Oxford University Press 2010).
[23] André Dao, Andrew Godwin and Ian Ramsay, 'From Enforcement to Prevention: International Cooperation and Financial Benchmark Reform' (2016) 10 Law and Financial Markets Review 83.

these services play in financial stability and the potential systemic risks they carry require comprehensive examination.[24] Thus, this research endeavors to present two case studies as examples to illustrate how the regulatory mechanisms of the EU to allow third-country CRAs and CCPs in the single market can impact third countries regulation. Through these case studies, the study seeks to enrich the understanding of equivalence and endorsement and the potential extraterritorial reach of EU law in the context of CRAs and CCPs.

This study has firstly chosen Australia as a pertinent case study for several compelling reasons. First and foremost, Australia's experience with the repeal of an equivalence decision concerning CRAs in 2019 offers a valuable opportunity to examine the potential implications of such regulatory actions.[25] This event marks a significant shift in the equivalence regulatory landscape and provides insights into how the EU's decision-making process regarding third-country CRAs can impact their operation within the EU single market.

Furthermore, Australia's position as a non-neighboring country with substantial trade relations in various financial services with the EU adds a dynamic layer to the analysis. This unique combination of geographical distance and the absence of economic interconnectedness with the EU makes it an excellent case study to understand how these factors can influence the EU's decisions concerning equivalence and endorsement and how it could have the potential to influence Australia financial regulation.

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[24] Oliver Everling and ML Trieu, 'Rating Agencies All Over the World' in Hans Egon Büschgen and Oliver Everling (eds), *A Credit Rating Compendium* (2nd edn, Gabler 2007); Alexandra Heath and others, 'CCPs and Network Stability in OTC Derivatives Markets' (2016) 27 Journal of Financial Stability 217.

[25] Commission Implementing Decision (EU) 2019/1276 of 29 July 2019 repealing Commission Implementing Decision 2012/627/EU on the recognition of the legal and supervisory framework of Australia as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies (European Commission Decision Repealing Australia's Equivalence) [2019] OJ L 201/17.

By studying Australia's experience, we can gain a deeper understanding of how the EU balances its regulatory objectives and navigates the challenges posed by regulatory cooperation with distant yet economically significant third countries.

This research also selected the UK as a case study to explore the concept of equivalence in the context of CCPs. The inclusion of the case study on UK CCPs is a judicious decision for this research due to several compelling reasons. Firstly, the UK's transition from an EU member state to a third country has substantial implications for the field of financial services, especially CCPs, given the concentration of these entities in the UK.[26] This case study offers a real-world example of how equivalence and regulatory mechanisms are navigated in a post-Brexit scenario. Moreover, the UK was chosen to be studied because some UKK CCPs has been considered systematically important through a significant amendment of EMIR introduced with EMIR 2.2, namely, the classification of CCPs into Tier 1, Tier 2, and Tier 3.[27] Moreover, the concept of comparable compliance is applicable to certain UK CCPs. Hence, it allows the research to go beyond territorial extension to encompass the realms of extraterritoriality.[28]

7 Main issue concerning the regulation of third-country CRAs and CCPs in the EU

Since the main goal of this research is to assess the impact of EU instruments (that allow third-country CRAs and CCPs to operate in the

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[26] Eilís Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (2017) 3 Journal of Financial Regulation 40.
[27] Stuart Weinstein, 'EMIR 2.2—Tier 2 CCPs—Does the Solution to This Potential EU-US Derivatives Regulatory Impasse Lie In Brexit?' (2019) 38 Banking & Financial Services Policy Report 1.
[28] Klaus Löber, 'Extraterritorial Application or Regulation in the Area of Financial Market Infrastructure: The Case for Cross-Border Cooperative Oversight' in Franklin Allen and others (eds), *European Financial Infrastructure in the Face of New Challenges* (European University Institute 2019).

EU) on the regulation of these services in third countries, a crucial aspect to consider is the potential extraterritorial reach of these regulatory instruments. This extraterritorial reach of EU law can manifest through two distinct concepts: extraterritoriality and territorial extension. Additionally, it may result in what is known as "The Brussels Effect," which has far-reaching implications on global regulatory standards. As such, this study will thoroughly examine these concepts to determine whether these are applicable to the cases f CRAs and CCPs and whether the EU instruments for third-country CRAs and CCPs are contributing to such extraterritorial reach.

7.1 Extraterritoriality

The notion of extraterritoriality in international law derives from the concept of jurisdiction.[29] However, extraterritoriality is sometimes used to describe any measures with effects beyond domestic borders. [30] In the EU's approach towards third-country CRAs and CCPs the presence of an extraterritorial measure can vary significantly depending on the financial service. For example, concerning CRAs, this research argues that equivalence does not have an extraterritorial effect because a measure is extraterritorial only if it assigns a duty to a person who has no territorial connection with the regulating state.[31] By contrast, in the case of CCPs, some provisions do have extraterritorial effects. For instance, the EU's modification of EMIR concerning the supervision of third-country CCPs by the ESMA or the new concept of Comparable Compliance.

[29] Robert Dover and Justin Frosini, 'The Extraterritorial Effects of Legislation and Policies in the EU and US European Parliament Study (May 2012) PE 433.701'.
[30] Joanne Scott, 'The New Extraterritoriality' (2014) 51 Common Market Law Review 1343.
[31] ibid.

7.2 Territorial extension

On the other hand, territorial extension is a concept introduced by J. Scott to establish a better understanding of the global reach of EU law.[32] As defined by J. Scott, "territorial extension" occurs when an action is generated through territorial connection but requires, in order to assess compliance with that action, the evaluation of foreign conduct or legislation.[33] In the context of CCPs, EMIR also introduced clearing obligations for entities in third countries involved in cross-border transactions.[34] Regarding CRAs, CRA Regulation I introduced a equivalence certification and endorsement that involve evaluating third countries' legislation to determine whether it meets the necessary standards for granting access to the EU single market. Hence, these are examples of the global reach of EU law by way of territorial extension.[35]

7.3 "The Brussels Effect"

Extraterritoriality and territorial extension have also provoked some criticism. For instance, the EU has been referred to as contributing to "unilateral regulatory globalization", better known as the "Brussels Effect".[36] This phenomenon occurs through territorial extension or

[32] Joanne Scott, 'Extraterritoriality and Territorial Extension in EU Law' (2014) 62 The American Journal of Comparative Law 87.
[33] Joanne Scott, 'The Global Reach of EU Law' in Marise Cremona and Joanne Scott (eds), *EU Law Beyond EU Borders, the extraterritorial reach of EU Law* (Oxford University Press 2019).
[34] EMIR Regulation (n 5); European Securities and Markets Authority (ESMA), 'Clearing Obligation and Risk Mitigation Tecniques under EMIR' <https://www.esma.europa.eu/regulation/post-trading/otc-derivatives-and-clearing-obligation> accessed 31 August 2023.
[35] Scott, 'The Global Reach of EU Law' (n 33); Marise Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' in Marise Cremona and Joanne Scott (eds), *EU Law Beyond EU Borders: The Extraterritorial Reach of EU Law* (Oxford University Press 2019).
[36] Anu Bradford, *The Brussels Effect: How the European Union Rules the World* (Oxford University Press 2020); Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32).

extraterritoriality as a result of the EU's institutional structure, which, together with a robust internal market, has increased the EU's influence as a global standards setter.[37] A. Bradford explains the *de jure* "Brussels effect" as the intentional or unintentional use of instruments that transfer EU legislation to third countries' law.[38] Indeed, this applies to the subject of this research as market access through some mechanisms available in EU law extends the reach of EU law to third countries' legislation in financial services through territorial extension and extraterritoriality.

8 Methodology

The EU has encountered challenges in achieving integration and legal harmonization in the realm of financial services. The regulation of this domain is inherently complex, encompassing various issues such as the fragmentation of services within the EU single market, disparities among Member States in managing financial services, and the role of regulation in maintaining financial stability.[39] These challenges are further magnified when considering the interaction between the EU and third countries, as global regulation of financial services remains highly fragmented as well.[40] However, the regulation of third-country CRAs and CCPs has showcased a different approach to regulation of financial services, international cooperation through endorsement and equivalence, respectively. Although developing regulatory frameworks for these services has been arduous, they have received more attention and progress compared to other financial services. Consequently, these financial services serve as a focal point for this research.

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[37] Bradford, 'The Brussels Effect: How the European Union Rules the World' (n 36).
[38] ibid.
[39] Quaglia, 'Financial Regulation and Supervision in the European Union after the Crisis' (n 2).
[40] Manuela Moschella and Catherine Weaver, *Handbook of Global Economic Governance, Players, Powers and Paradigms* (Routledge 2014).

Moreover, given that this study aims to examine the impact of regulatory instruments established by the EU to enable third-country CRAs and CCPs to access the single market, it is crucial to consider how EU law addresses these services and its relationship with third countries. Consequently, the research question of this dissertation cannot be examined in isolation but must be analyzed within the broader context of CRAs and CCPs regulation in the EU.

To adequately explore the research question, the structure of this dissertation is of utmost importance. The study is organized based on a methodological framework that encompasses the aforementioned considerations, particularly focusing on the EU's chosen instruments to regulating CRAs and CCPs in the presence of non-EU participants: endorsement and equivalence. With this objective in mind, the chapters of this dissertation are arranged to follow a logical sequence. Firstly, the conceptual framework of CRAs and CCPs is analyzed, along with the concepts of global reach of EU law encompassing an analysis of territorial extension, extraterritoriality and the "Brussels Effect" in the selected financial services. Subsequently, the international and EU legal framework governing CRAs and CCPs is examined, with a specific focus on how it applies to third-country CCPs and CRAs. Finally, the practical perspectives of third-country CRAs and CCPs are explored through the examination of two case studies. This structure aims to present an accurate portrayal of the impact of regulatory instruments established by the EU to enable third-country CRAs and CCPs to access the single market.

The analyses and conclusions presented in this study primarily draw upon academic research, specifically legal sources including relevant provisions under EU and financial law, academic literature, and soft law pertaining to the selected financial services.

9 Structure

This is a comprehensive study that delves into the impact of regulatory instruments established by the EU to enable third-country CRAs and CCPs to access the single market. This dissertation is organized into three parts, containing seven chapters. Part I begins with an introductory Chapter I, which provides an overview of the research, introduces the research question, defines the study's scope, and outlines the chosen methodology. This chapter specifically focuses on endorsement and equivalence as the measures used to grant access for third-country CRAs and CCPs to the EU single market. It also explains the rationale behind selecting CRAs and CCPs as the subjects of study, identifies the countries chosen for the case study, and highlights the key issues regarding the impact of EU's regulatory instruments on third countries' regulation. Chapter II delves into an in-depth analysis of the fundamental elements of CRAs and CCPs, considering their significance and characteristics within the EU's financial services landscape. Chapter III then explores the global reach of EU law in financial services and discusses controversies surrounding equivalence decisions and endorsement, while Chapter IV. examines the legal framework governing the selected financial services globally and Chapter V delves into the regulation of CRAs and CCPs in the EU. In Chapter VI, the study addresses the concept of "third-country" in the context of the selected financial services and explores the challenges they pose to regulation and supervision. Later, Chapter VII presents case studies of third countries, including the UK and Australia, analyzing their provision of CRAs and CCPs services to the EU. This dissertation concludes by delivering a concise summary of its findings, presenting a prospective solution to the identified issues within equivalence and endorsement, and underscoring the nuanced mechanisms through which the global reach of

EU law permeates third countries by means of the instruments facilitating entry into the EU's single market.

PART I: CONCEPTUAL FRAMEWORK

CHAPTER II: Foundational Elements of Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) - Pillars of Financial Services in the EU.

This chapter aims to explore the fundamental concepts of Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) in the context of financial services regulation. It will focus on the key concepts that are essential for comprehending the regulatory framework governing these services. Additionally, it will emphasize the significance of these concepts in elucidating the differences in regulations and requirements applicable to third-country CRAs and CCPs. By delving into these core concepts, we can gain a comprehensive understanding of the complexities surrounding the regulation of third-country CRAs and CCPs and their interaction with the EU's regulatory framework.

First of all, it is crucial to categorize financial services to recognize the distinct regulatory frameworks that govern each category. Financial regulation can significantly vary depending on the type of service being offered. In the field of financial services, there are five primary categories:[41]

-Insurance Services: This category covers services provided by insurance companies, including underwriting policies and handling insurance-related transactions.

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[41] Lucia Quaglia, *The European Union and Global Financial Regulation* (Oxford University Press Scholarship Online 2014). This classification, as suggested by Quaglia, is primarily based on the global regulation of those financial services. However, it is essential to acknowledge that the regulatory landscape of these services may vary across different countries. Consequently, the classification proposed by Quaglia might not be universally applicable and could differ based on individual countries' regulatory frameworks.

-Banking Services: Services offered by banks, such as deposit-taking, lending, and other financial intermediation activities fall under this category.

-Securities Services: This category encompasses services related to the trading, issuance, and management of securities, such as stocks, bonds, and derivatives.

-Accounting Services: This category involves services related to financial reporting, bookkeeping, and auditing, crucial for ensuring financial transparency and compliance.

-Auditing Services: Auditing services involve independent assessments of financial records and reporting to verify their accuracy and reliability.

In the EU, CRAs are considered to belong to the field of Securities regulation and supervision. This is because CRAs primarily provide credit ratings for debt securities issued by various entities, such as governments, corporations, and financial institutions.[42] The ratings produced by CRAs have far-reaching implications, including informing regulators about the creditworthiness of various entities. Specifically, these ratings are used to determine capital requirements, which are essential for assessing the financial stability of banks and other financial institutions.[43] However, while CRAs may play a role in assessing the creditworthiness of banks and their debt issuances, they are not considered a part of the Banking regulatory framework in the EU. Instead, they are subject to specific regulations tailored to the unique

[42] S Utzig, 'The Financial Crisis and the Regulation of Credit Rating Agencies: A European Banking Perspective' (2010) 188 Asian Development Bank Institute (ADBI) Working Paper Series 1.
[43] Timothy E Lynch, 'Deeply and Persistently Conflicted: Credit Rating Agencies in the Current Regulatory Environment' (2009) 59 Case Western Reserve Law Review 227.

characteristics of credit rating services and their role in the securities markets.

In the context of this research, the focus will be on ratings that serve regulatory purposes, particularly those used by regulators to establish capital requirements. Understanding how these ratings are applied and regulated is essential when examining the provision of CRAs' services by third-country entities, as it may involve distinct requirements and considerations compared to other financial services.

On the other hand, CCPs fall under the category of Securities Services because they play a crucial role in facilitating transactions of securities, with a particular emphasis on Over-The-Counter (OTC) derivatives, which is the primary focus of this research.

CCPs act as intermediaries in the trading process, assuming the role of a buyer to every seller and a seller to every buyer in a transaction.[44] By doing so, they provide a level of security and risk management to the financial markets. In the case of OTC derivatives, which are privately negotiated contracts, CCPs play a critical role in standardizing and clearing these contracts, reducing counterparty risk and enhancing market stability.[45] Furthermore, understanding that CCPs operate within the realm of securities is essential in comprehending their regulatory framework and the implications of their provision by third-country entities within the EU's regulatory landscape.

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[44] Board of the International Organization of Securities Commissions (IOSCO) and Committee on Payments and Market Infrastructures (CPMI), 'Resilience of Central Counterparties (CCPs): Further Guidance on the PFMI (July 2017)'.

[45] Jo Braithwaite, 'The Dilemma of Client Clearing in the OTC Derivatives Markets' (2016) 17 European Business Organization Law Review 355.

1 Credit Rating Agencies (CRA)

1.1 Literature review

The concept of Credit Rating Agency (CRA) has been a subject of considerable scholarly interest and regulatory scrutiny in the financial literature. CRAs play a pivotal role in providing independent assessments of credit risk, influencing investors' decisions and therefore, having serious consequences for the financial sector.[46] Research by White, Wessendorf and McVea highlights the role of CRAs in disseminating information and contributing to the subprime mortgage financial crisis in 2007.[47] Similarly, Caliari and Blaurock emphasize that the crisis highlighted the vulnerabilities in both risk management practices within CRAs and the incentive system established by regulators and supervisors through capital and liquidity requirements and oversight.[48] Hence, the literature has also raised concerns about CRAs, such as, potential conflicts of interest within the CRA industry, lack of transparency and over reliance on the ratings. As a result, the literature including IOSCO's reports recommended reevaluating the regulatory framework governing CRAs to address these issues effectively.[49] Indeed, to address these issues,

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[46] International Organization of Securities Commissions IOSCO. Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies (May 2008)' (2008).

[47] Lawrence J White, 'Markets, The Credit Rating Agencies' (2010) 24 Journal of Economic Perspectives 211; Erin M Wessendorf, 'Regulating the Credit Rating Agencies' (2009) 3 Entrepreneurial Business Law 87 Harry McVea, 'Credit Rating Agencies, the Subprime Mortgage Debacle and Global Governance: The EU Strikes Back' (2010) 59 International and Comparative Law Quarterly 701.

[48] Aldo Caliari, 'Assessing Global Regulatory Impacts of the U. S. Subprime Mortgage Meltdown: International Banking Supervision and the Regulation of Credit Rating Agencies' (2010) 19 Transnational Law & Contemporary Problems 145; Uwe Blaurock, 'Control and Responsibility of Credit Rating Agencies' (2009) 11 Electronic Journal of Comparative Law.

[49] Frank Partnoy, 'Rethinking Regulation of Credit Rating Agencies : An Institutional Investor Perspective' [2009] Council of Institutional Investors 1.Edward I Altman and others, 'Regulating of Rating Agencies' in Viral V. Acharya and others (eds), *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (Wiley 2010). Stephane Rousseau, 'Regulating Credit Rating Agencies after the Financial Crisis:

regulatory reforms have been implemented globally, such as the Dodd-Frank Act in the United States and the European Securities and Markets Authority's (ESMA) CRA Regulation I. These regulations aim to enhance transparency and improve the accuracy of credit ratings.[50] Furthermore, Miglionico and Hiss study the impact of CRA's ratings on stock prices during the 2008 financial crisis, highlighting the need for accurate and timely credit assessments by CRAs to prevent market disruptions.[51]

The importance of CRAs' ratings in the financial system is also evident in the use of ratings for regulatory purposes. In fact, in 2009, the Joint Forum of Financial Conglomerates conducted a survey, which disclosed that financial regulators, particularly those overseeing banks, persisted in heavily depending on credit ratings to assess compliance with prudential regulatory obligations.[52] In this regard, Alexander, Weber and Darbellay examine the reasoning behind the use of credit ratings in the regulation of financial markets, with a particular emphasis on bank capital regulation and report that contends that removing external ratings from bank capital regulation is necessary, as they have the potential to amplify significant financial risks. However, despite these concerns, the EU continues to use those ratings in its financial regulations.

The Long and Winding Road Toward Accountability'. Technical Comittee of International Organization of Securities Commissions (IOSCO), 'The Role of Credit Rating Agencies in Structured Finance Markets (May 2008)'. Committee of European Securities Regulators (CESR), 'CESR's Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and the Role of Credit Rating Agencies in Structured Finance (May 2008) CESR/08-277'.

[50] Aline Darbellay and Frank Partnoy, 'Credit Rating Agencies and Regulatory Reform' in Claire A Hill and Brett H Mcdonnell (eds), *Research Handbook on the Economics of Corporate Law* (Edward Elgar Publishing 2012).

[51] Stefanie Hiss and Sebastian Nagel, 'Credit Rating Agencies' in Daniel Mügge (ed), *Europe and the Governance of Global Finance* (Oxford University Press 2014); Andrea Miglionico, 'Market Failure or Regulatory Failure? The Paradoxical Position of Credit Rating Agencies' (2014) 9 Capital Markets Law Journal 194.

[52] Basel Committee on Banking Supervision-The Joint Forum, 'Stocktaking on the Use of Credit Ratings (June 2009)'.

Moreover, scholars have explored the global coordination of CRA regulations, especially in the context of cross-border financial services. Moloney and Quaglia discuss the implications of the EU's equivalence framework for CRAs from third countries, emphasizing the challenges of harmonizing regulatory standards across jurisdictions.[53]

The existing literature on CRAs offers valuable insights into their role within the financial system, the regulatory landscape they navigate, and the possible risks and advantages of their credit ratings. However, it is crucial to note that limited attention has been given to the potential extraterritorial impacts of certain provisions, which is precisely the focal point of this dissertation. By exploring the extraterritorial reach of EU regulations concerning CRAs and CCPs, this research aims to shed light on the influence of these provisions on third-country regulations and their interaction with global financial standards.

1.2 The importance of Credit Rating Agencies (CRAs)

During the worldwide crisis, credit rating agencies faced criticism for amplifying systemic risk due to their function as intermediaries of information between investors and issuers in the financial markets.[54] However, ratings do not provide an exact prediction of the frequency of

[53] Niamh Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' in Danny Busch, Emilios Avgouleas and Guido Ferrarini (eds), *Capital Markets Union in Europe* (Oxford University Press 2018); Lucia Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (2015) 38 Western European Politics 167.

[54] Andreas Kruck, 'Asymmetry in Empowering and Disempowering Private Intermediaries: The Case of Credit Rating Agencies' (2017) 670 The ANNALS of the American Academy of Political and Social Science 144.

default or loss, by contrast, they provide a comparative assessment of risk levels.[55]

Credit rating agencies (CRAs) are privately owned entities that offer public assessments regarding the creditworthiness of debt instruments such as bonds and commercial paper.[56] These agencies primarily rely on commission fees for their financial support.[57] In this regard, the EU defined credit rating in the CRA Regulation I as "(…) an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories."[58]

In the context of the European Union's regulatory oversight regime, CRAs hold large significance due to their role in independently assessing and providing ratings for financial instruments.[59] Their ratings serve as crucial information for market participants, investors, and regulators, enabling them to make informed decisions and assess the potential risks and returns of investments.[60] By establishing a regulatory oversight regime for CRAs, the EU ensures the reliability and integrity of credit ratings used within its internal market. Furthermore, CRAs are subject to a legal framework established by EU law which governs their operations and

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[55] Daniel Fennel and Andrei Medvedev, 'An Economic Analysis of Credit Rating Agency Business Models and Ratings Accuracy' (2011) 41 Financial Services Authority Occasional Paper.
[56] Andrea Miglionico, *The Governance of Credit Rating Agencies. Regulatory Regimes and Liability Issues.* (First, Edward Elgar Publishing 2019), 2.
[57] ibid.
[58] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I).
[59] Dieter Kerver, 'Standardizing as Governance: The Case of Credit Rating Agencies' in Adrienne Héritier (ed), *Common Goods: Reinventing European Integration Governance* (Rowman & Littlefield Publishers 2002).
[60] Basel Committee on Banking Supervision, 'Credit Ratings and Complementary Sources of Credit Quality Information (July 2000)'.

determines their recognition and acceptance within the EU.[61] This recognition allows the ratings issued by CRAs established in third countries to be utilized for regulatory purposes within the EU.[62]

1.3 Financial Regulation and the Pivotal Role of Credit Rating Agencies in the 2008 Financial Crisis

Following the financial crisis in 2007, legislators and regulators have recognized the necessity for structural reforms within the credit rating industry.[63] Consequently, the EU regulation of CRAs and the implementation of the Dodd–Frank Wall Street Reform and Consumer Protection Act 2010 (the Dodd–Frank Act) caused a significant shift in the role and position of CRAs within contemporary financial markets.[64]

In recent years, there have been three distinct phases in the regulatory structure of the credit rating industry, each of which has had implications for the role of CRAs in financial market regulations. Initially, from the early 20th century until the 1970s, CRAs operated without significant regulation and were not extensively utilized in financial market regulatory frameworks.[65]

The second phase, particularly starting from the 1970s, witnessed a growing reliance on CRAs for regulatory purposes, despite the absence of formal regulations specifically targeting them.[66] During this period, CRAs

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[61] Raquel García-Alcubilla and Javier Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation', *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (Oxford University Press 2012).
[62] ibid.
[63] Aline Darbellay, *Regulating Credit Rating Agencies* (Edward Elgar Publishing 2013).
[64] Aline Darbellay, 'Regulating Ratings, The Credit Rating Agency Oligopoly from a Regulatory Perspective' in Dieter Zobl, Mario Giovanoli and Rolf H Weber (eds), *Schweizer Schriften zum Finanzmarktrecht* (Schulthess 2011).
[65] Organisation for Economic Co-operation and Development (OECD), 'Competition and Credit Rating Agencies (05 October 2010) DAF/COMP (2010) 29'.
[66] Darbellay, 'Regulating Credit Rating Agencies' (n 63).

gained prominence as information intermediaries between investors and issuers, with their ratings being used as a basis for regulatory decisions.[67]

However, the third phase led to a transition period that aims to reshape the regulatory landscape for credit rating agencies. The objective was to subject CRAs to more stringent regulations, affiliated to those imposed on other gatekeepers in the financial industry such as auditors and securities analysts.[68]

1.4 Useful Concepts in the Regulation of Credit Rating Agencies: Understanding the Framework and Impact in Financial Services.

1.4.1 Credit Rating Agency

The IOSCO Code of Conduct and CRA Regulation I in the EU share a very similar concept of a Credit Rating Agency, defining it as an entity that is in the business of issuing Credit Ratings, with the slight difference of the phrase "on a professional basis" included in CRA Regulation I.[69] Hence, the importance of the concept lies in the meaning of Credit Rating, which is defined in Article 3 of CRA Regulation I as "an opinion regarding the creditworthiness of an entity, a debt or financial obligation, debt security, preferred share or other financial instrument, or of an issuer of such a debt or financial obligation, debt security, preferred share or other financial instrument, issued using an established and defined ranking system of rating categories".

[67] ibid.
[68] Niamh Moloney, 'Gatekeeper Regulation and the EU', *EU Securities and Financial Markets Regulation* (3rd edn, 2014).
[69] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies' (n 5); CRA Regulation I (n 58).

1.4.2 Rating Category

Article 3 (1) (h) of the Regulation defines a "rating category" as a symbol used in credit ratings to indicate the relative level of risk and distinguish the different risk characteristics of rated entities, issuers, financial instruments, or other assets.[70] Credit rating agencies (CRAs) assign rankings to securities and issuers on a comparative scale. For instance, Fitch and S&P utilize symbols like AAA, AA, A, BBB, BB, while Moody's employs Aaa, Aa, A, Baa, Ba.[71] Additionally, CRAs may include modifiers (e.g., '+', '-', '1', '2', '3') alongside rating categories to denote relative distinctions within the main categories.[72] When a credit rating is changed, it means it has been assigned a different position on the rating scale, known as a "notch".[73]

It's important to note that rating categories do not represent absolute measures of risk but indicate that securities in higher categories generally possess higher quality than those in lower categories.[74] However, in practice, market participants often ascribe certain absolute values to each rating category, irrespective of their relative positions.[75] This tendency is also observed among banking supervisors who assign specific risk weights to each category under the standardized approach of the Capital Requirement Directives (CRDs).[76]

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[70] CRA Regulation I (n 58).

[71] Amadou Sy, 'The Systemic Regulation of Credit Rating Agencies and Rated Markets IMF Working Paper (June 2009) WP/09/129' (2009).

[72] White, 'Markets, The Credit Rating Agencies' (n 47).

[73] Jeffery D Amato and Craig H Furfin, 'Are Credit Ratings Procyclical?' (2003) 129 BIS Working Papers.

[74] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).

[75] Basel Committee on Banking Supervision (BCBS), 'A Global Regulatory Framework for More Resilient Banks and Banking System' (2010).

[76] ibid.

1.4.3 Credit Rating Activities

Credit rating agencies offer evaluations of issuers' capacity to fulfill their debt obligations by providing monitoring services that facilitate the liquidity of markets.[77] Additionally, Credit Rating Agencies can be classified as intermediaries that provide certifications or reputation-based intermediaries.[78]

In this regard, credit rating agencies offer two crucial services. Firstly, they provide solicited ratings, which occur when an issuer pays a fee to request a rating for its securities.[79] Secondly, they offer unsolicited ratings, which are based solely on publicly available information and no payment is involved.[80] This distinction is very important to understand how the regulation of this service works.

The credit rating agency business model, known as the "issuer-pays" model, involves the rating agencies being compensated by the very entities whose products they evaluate.[81] The main rating firms (Moody's Investors Service, Standard & Poor's Ratings Services and Fitch Ratings) transitioned from the "Investor pays" model, established by John Moody in 1909, to the issuer pays model.[82] It is noteworthy that the entities whose products are being rated are the ones funding the ratings.[83] For this reason, credit rating agencies are very controversial. Despite this, the

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[77] John Kiff and others, 'The Uses and Abuses of Sovereign Credit Ratings' (2010).
[78] John C Coffee Jr, *Gatekeepers: The Professions and Corporate Governance* (Oxford University Press 2006).
[79] Miglionico, 'The Governance of Credit Rating Agencies. Regulatory Regimes and Liability Issues' (n 56).
[80] Rousseau (n 49).
[81] Moloney, 'Gatekeeper Regulation and the EU' (n 68).
[82] Miglionico, 'Market Failure or Regulatory Failure? The Paradoxical Position of Credit Rating Agencies' (n 51).
[83] Miglionico, 'The Governance of Credit Rating Agencies. Regulatory Regimes and Liability Issues' (n 56).

credit rating agency's credibility derives from the accumulated reputational capital it has built over numerous years of providing similar services to various clients.[84]

1.4.4 The Use of Ratings for Regulatory Purposes

The utilization of CRAs for regulatory objectives holds significant relevance when considering CRAs from third countries operating within the EU. This is due to the fact that credit ratings provided by these agencies can serve as a means of adhering to EU regulations when they are implemented within the individual Member States.[85]
Regulators expressed concerns about the possible adverse effects of incorporating ratings into regulations during the 2007 crisis, as some believed that these references in the legislation may have led to an excessive dependence on ratings by market participants.[86]
Regarding this matter, the, then, Financial Stability Forum (FSF) currently Financial Stability Board (FSB), in its "Report on enhancing market and institutional resilience" published in April 2008 at the request of the G7 Ministers and Central Bank Governors, concluded that the inclusion of ratings in various regulatory and supervisory frameworks might have contributed to investors relying excessively on these ratings.[87]

The FSB recommended that authorities assess whether the roles assigned to ratings in regulations and supervisory rules align with the objective of enabling investors to make independent risk judgments and perform their

[84] John C Coffee Jr, 'Understanding Enron: "It's about the Gatekeepers, Stupid"' (2002) 57 The Business Lawyer 1405.
[85] Darbellay and Partnoy (n 50).
[86] European Securities and Markets Authority (ESMA), 'Consultation Document on Policy Options to Address the Problem of Excessive Reliance on Ratings' (2008).
[87] Financial Stability Forum (FSF) currently Financial Stability Board (FSB), 'Report on Enhancing Market and Institutional Resilience' (2008).

own due diligence, without relying unquestionably on credit ratings as a substitute for independent evaluation.[88]

As a result, the FSB requested the Joint Forum to conduct an assessment of how its member authorities in the banking, securities, and insurance sectors utilized external credit ratings.[89] The Joint Forum was created in 1996 through the collaboration of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS) and its purpose was to address shared concerns and challenges in the banking, securities, and insurance sectors, encompassing topics such as the oversight of financial conglomerates and regulatory matters.[90] To fulfill this request, the Joint Forum distributed a questionnaire to its members, seeking information on the use of credit ratings in legislation, regulations, and supervisory policies developed or influenced by public authorities.

Based on the findings of the Joint Forum, credit ratings were commonly used in legislation to determine capital requirements; classify assets, typically in relation to eligible investments or acceptable asset concentrations; provide a credible assessment of credit risk for assets involved in securitization or covered bond offerings; establish disclosure requirements; and ascertain prospectus eligibility.[91] For example, in the US under the Banking Act, banks were mandated to rely on external credit ratings to evaluate the creditworthiness of their assets and to furnish investors and depositors with a risk rating of those assets. The intention

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[88] ibid.

[89] Basel Committee on Banking Supervision-The Joint Forum, Basel Committee on Banking Supervision-The Joint Forum, 'Stocktaking on the Use of Credit Ratings' (n 52).

[90] Kevin Young, 'Joint Forum' in Thomas Hale and David Held (eds), *The Handbook of Transnational Governance: Institutions and Innovations* (John Wiley & Sons 2011).

[91] Basel Committee on Banking Supervision-The Joint Forum, 'Stocktaking on the Use of Credit Ratings' (n 52).

behind employing ratings to assess the risk of bank assets was to offer regulators insights into the level of risk associated with a particular institution and to establish a legal foundation for regulatory intervention in bank management when excessive risk-taking was evident.[92]

In an illustrative scenario, the process unfolds as follows: There are two hypothetical countries, namely Country A and Country B. In Country A, the financial regulators rely heavily on credit ratings issued by the A Credit Rating Agency (ACRA) to determine compliance with their banking legislation. ACRA assigns credit ratings to various financial institutions in Country A, such as banks and non-bank lenders, based on their creditworthiness and risk profiles. Under Country A banking legislation, banks with a credit rating of "AAA" are considered to have the highest creditworthiness and are subject to less stringent capital requirements. On the other hand, banks with lower ratings, such as "BBB" or "CCC," are deemed to have a higher level of credit risk and are required to hold higher levels of capital to safeguard against potential losses. In this hypothetical scenario, the regulators in Country A heavily rely on ACRA's credit ratings to assess the stability and soundness of its banking sector. The use of these ratings in the regulatory framework aims to ensure that financial institutions maintain adequate capital buffers and operate in a prudent manner to mitigate systemic risks.

The use of credit ratings for regulatory purposes has been a subject of intense debate due to the potential risks associated with relying solely on a CRA's assessment to establish legal requirements for financial institutions. Critics argue that such heavy dependence on credit ratings can create vulnerabilities in the regulatory framework, leading to a lack

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[92] Kern Alexander, 'The Risk of Ratings in Bank Capital Regulation' (2014) 25 European Business Law Review 295.

of comprehensive risk analysis and potentially jeopardizing financial stability.[93]

1.4.5 The Use of Ratings in the Financial Market

In today's financial markets, credit ratings from third-party rating agencies have become crucial for investors, securities issuers, and financial institutions when making investment decisions and ensuring regulatory compliance. These rating agencies have emerged as the primary source for assessing credit risks, and various regulations mandating the use of external ratings have further solidified their position, leading to an oligopolistic structure dominated by three major agencies - Moody's, Standard and Poor's, and Fitch.[94]

Recent literature highlights that this market concentration has hindered competition and negatively impacted the quality of ratings.[95] Additionally, their pivotal role in evaluating investment risks for regulated institutional investors and determining regulatory capital for banks has grown significantly, posing a potential threat to the smooth functioning of financial markets.[96] The heavy reliance on these agencies has contributed to market failures, raising concerns about their influence and implications for financial stability and efficiency.[97]

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[93] Rolf H Weber and Aline Darbellay, 'The Regulatory Use of Credit Ratings in Bank Capital Requirement Regulations' (2008) 10 Journal of Banking Regulation 1.
[94] Darbellay, 'Regulating Ratings, The Credit Rating Agency Oligopoly from a Regulatory Perspective' (n 64).
[95] Darbellay and Partnoy (n 50); Fabian Amtenbrink and Jakob De Haan, 'Regulating Credit Ratings in the European Union: A Critical First Assessment of Regulation 1060/2009 on Credit Rating Agencies' (2009) 46 Common Market Law Review 1915; Fabian Amtenbrink and Klaus Heine, 'Regulating Credit Rating Agencies in the European Union. Lessons from Behavioural Science' (2013) 1 Dovenschmidt Quarterly (DQ) 1; Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92).
[96] Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92).
[97] Gudula Deipenbrock and Mads Andenas, 'Editorial Introduction: Regulating Credit Rating Agencies in the EU' (2014) 25 European Business Law Review 205.

1.5 Registration Process and Requirements in the European Union

Significant transformations were implemented in the registration process for Credit Rating Agencies (CRAs) following the amendment to Regulation 1060/2009 in 2011 and 2013. Among the notable modifications was the pivotal shift in responsibility for the registration and supervision of CRAs. Previously handled by competent authorities appointed by individual Member States,[98] these crucial tasks were transferred to the European Securities and Markets Authority (ESMA). This transfer of authority marked a significant change in the regulatory landscape governing CRAs within the European Union.

In particular, the amendment on this matter stipulates that:

"Without prejudice to Articles 16 or 17, ESMA shall register the credit rating agency if it concludes from the examination of the application that the credit rating agency complies with the conditions for the issuing of credit ratings set out in this Regulation, taking into consideration Articles 4 and 6. ESMA shall not impose requirements regarding registration which are not provided for in this Regulation." [99]

These paragraphs aim to delineate a transparent and equitable registration process, while establishing a harmonized regulatory framework to ensure consistency and fairness for CRAs. The objective is to shield CRAs from potential inconsistencies that could arise from

[98] Committee of European Securities Regulators (CESR), 'Guidance on Registration Process, Functioning of Colleges, Meadiation Protocol, Information Set out in Annex II, Information Set for the Application for Certification and for the Assessment of CRAs Systemic Importance (Ref. CESR/09-955)' (2009).

[99] 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 [2011] OJ L 145/30 (CRA Regulation II).

multiple EU supervisors who were previously responsible for registration and supervision.[100] Furthermore, the aim is to safeguard CRAs from any arbitrary requests that may arise from the European Securities and Markets Authority (ESMA), which has assumed these responsibilities.[101]

2 Central Counterparties (CCPs)

2.1 Literature Review

The concept of Central Counterparties (CCPs) has garnered significant attention in the literature due to its crucial role in mitigating counterparty risk in financial markets. CCPs act as intermediaries between buyers and sellers of financial instruments, guaranteeing the fulfillment of contractual obligations even if one party defaults.[102] This risk-mitigating function has been extensively studied in the literature.[103] For instance, Nabilou, Asimakopoulos and Balmer highlight the systemic importance of CCPs, emphasizing how they can enhance market stability as they work as a circuit breaker, interrupting the spread of default risks between different counterparties.[104] Additionally, Szpringer examines the economics of CCPs and discusses how the obligation of central clearing and reporting

[100] European Parliament, 'Resolution on Credit Rating Agencies: Future Perspectives (2011/2302 (INI))' (2011).
[101] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).
[102] Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS), 'Principles for Financial Market Infrastructures (April 2012)'.
[103] Randy Priem and Alexandre Girard, 'Risk Management Practices of Central Counterparties : European vs Third-Country CCPs' (2022) 6 Journal of Insurance and Financial Management 125; Luc Nijs, 'Central Counterparties (CCPs) and Systemic Risk', *The Handbook of Global Shadow Banking, Volume I From Policy to Regulation* (Springer 2020); Peter Norman, *The Risk Controllers: Central Counterparty Clearing in Globalised Financial Markets* (John Wiley & Sons 2011).
[104] Hossein Nabilou and Ioannis G Asimakopoulos, 'In CCP We Trust ... or Do We? Assessing the Regulation of Central Clearing Counterparties in Europe' (2020) 15 Capital Markets Law Journal 70; Alexandra G Balmer, *Regulating Financial Derivatives Clearing and Central Counterparties* (Edward Elgar Publishing 2018).

promotes integrity and stability of the financial market.[105] This is because one of the changes implemented in response to the global financial crisis includes the commitment to clear standardized contracts through CCPs in the over-the-counter (OTC) derivative markets.[106]

Consequently, the literature has also sparked discussions surrounding the potential concentration of significant risk in a single entity due to the mandatory clearing obligation of OTC derivatives.[107] Scholars and researchers have expressed concerns about the implications of such concentration on the overall stability and resilience of the financial system. Studies by Huang and Baker delve into the risks associated with the centralization of clearing activities within a single CCP and explore the need for robust risk management practices and regulatory oversight to address this challenge effectively.[108] These discussions have contributed to ongoing policy debates on the appropriate regulatory approach to ensure financial stability while striking a balance between the benefits of mandatory clearing and the potential risks associated with concentrated clearing obligations. Overall, the literature underscores the critical role of CCPs in modern financial markets and emphasizes the importance of

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[105] Wlodzimierz Szpringer and Mariusz Szpringer, 'Law and Economics of Central Counterparties (CCP) Selected Issues of Regulation and Competition Concerning Financial Market Infrastructure' (2016) 27 European Business Law Review 587.
[106] Adam W Glass, 'The Regulatory Drive towards Central Counterparty Clearing of OTC Credit Derivatives and the Necessary Limits on This' (2009) 4 Capital Markets Law Journal S79.
[107] Jon Gregory, *Central Counterparties: Mandatory Central Clearing and Initial Margin* (John Wiley & Sons 2014); Romualdo Canini, 'Central Counterparties Are Too Big for the European Securities and Markets Authority (Alone): Constructive Critique of the 2019 CCP Supervision Regulation' (2021) 22 European Business Organization Law Review 673; Froukelien Wendt, 'Central Counterparties: Addressing Their Too Important to Fail Nature IMF Working Paper (January 2015) WP/15/21' 15.
[108] Jiabin Huang, *The Law and Regulation of Central Counterparties* (Hart Publishing 2010); Baker (n 7).Matthias Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (2023) 18 SSRN Electronic Journal 5.

adequate regulation and risk management practices to safeguard financial stability.

2.2 The importance of Central Counterparties (CCPs)

Due to historical factors, there may still be prevailing notions that group CCPs and other types of clearing houses together.[109] It is true that they share certain common functions, as central counterparties have evolved from earlier forms of clearing houses. Initially, clearing houses, especially in commodities markets, were established to ensure trade settlement and provide guarantees.[110] To some degree, CCPs fulfill a similar role. However, over time, the distinctions between them have become increasingly acknowledged and understood. In fact, CCPs and other types of clearing houses possess distinct characteristics that warrant their differentiation from each other. The main difference between these two concepts is that CCPs are the primary counterparty in the transactions involved, whereas other forms of clearinghouses may, at most, act as calculation agents in preparation for settlement.[111]

The distinctions go beyond the processing techniques and are also reflected in legal terms. From a legal perspective, the methods employed by these other clearinghouses differ significantly from those employed by CCPs.[112] For instance, in these alternative clearinghouses, clearing members maintain contractual obligations with each other regarding the

[109] Huang, The Law and Regulation of Central Counterparties (n 108).
[110] Joanna Benjamin, Madeleine Yates and Gerald Montagu, *The Law of Global Custody* (2nd edn, Butterworths 2002).
[111] Robert R Bliss and Robert Steigerwald, 'Derivatives Clearing and Settlement: A Comparison of Central Counterparties and Alternative Structures' (2006) 30 Economic Perspectives 22.
[112] Max Weber, 'Central Counterparties in the OTC Derivatives Market from the Perspective of the Legal Theory of Finance, Financial Market Stability and the Public Good' (2016) 17 European Business Organization Law Review 71.

underlying transactions they are involved in.[113] In contrast, the aim of CCP clearing is to replace the contractual relationships between CCP member participants exclusively with those between an individual member and the CCP.[114] These distinctions between CCPs and other types of clearinghouses are particularly crucial when examining legal matters, as these concepts play a significant role in the field. Understanding the fundamental differences between CCPs and clearing houses is essential in the development of an effective regulatory framework for CCPs, as the regulation can often mistakenly treat both concepts as interchangeable. Therefore, it is fundamental to accurately define and differentiate between CCPs and clearing houses to ensure appropriate and tailored regulatory measures are put in place.

2.3 Financial Regulation and the Pivotal Role of Central Counterparties in the 2008 Financial Crisis

In recent decades, various market events, particularly the 2007-2008 financial crisis, have emphasized the significance of CCP clearing in shaping an effective post-trade infrastructure.[115] In fact, it demonstrated resilience during the crisis. As a result, the role played by CCPs in post-crisis financial markets has sparked greater interest from national authorities and international standard-setting bodies in the regulation of CCPs. This success can be partly attributed to efforts aimed at reducing systemic risk based on past events, such as the paperwork crisis in the late 1960s and the 1987 market break in the United States.[116] On the

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[113] Richard Dale, 'Derivatives Clearing Houses: The Regulatory Challenge' (1997) 12 Journal of International Banking Law 46.
[114] Michael Blair and George Walker, *Financial Services Law* (Oxford University Press 2006).
[115] Huang, The Law and Regulation of Central Counterparties (n 108).
[116] Norman, The Risk Controllers: Central Counterparty Clearing in Globalised Financial Markets (n 103).

other hand, following the 2007-2008 financial crisis, the G20 reached a consensus to enforce a clearing mandate, which establishes the clearing of all standardized over-the-counter derivatives through a central counterparty (CCP).[117]

The establishment of such measure has been a challenge to financial regulation worldwide. One of the aims of financial regulation is to establish a market that is fair, transparent, and efficient.[118] The post-trade infrastructure, which is an integral part of a modern financial system, serves the needs of the markets it operates in.[119] However, the complexities of today's financial markets are reflected in the intricate design of the modern post-trade infrastructure and its regulation.[120] These complexities arise from the diverse range of financial transactions that need to be supported, while also considering the regulatory framework that seeks to safeguard market integrity and protect the interests of investors.[121]

Concerning CCPs, the objective is to ensure that they contribute to enhancing market efficiency and minimizing systemic risk.[122] In this

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[117] Rebecca Lewis, 'A "Principled" Approach to International Guidance for Central Counterparties'.

[118] Ana Fiorella Carvajal and others, 'The Perimeter of Financial Regulation' (2009) SPN/09/07.

[119] Guido Ferrarini and Paolo Saguato, 'Governance and Organization of Trading Venues: The Role of Financial Market Infrastructures Groups' in Danny Busch and Guido Ferrarini (eds), *Regulation of the EU Financial Markets. MiFID II and MiFIR* (Oxford University Press 2017).

[120] Guido Ferrarini and Paolo Saguato, 'Regulating Financial Market Infrastructures' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (2015).

[121] Emilios Avgouleas, 'The Global Financial Crisis and the Disclosure Paradigm in European Financial Regulation: The Case for Reform' (2009) 6 European Company and Financial Law Review.

[122] Robert S Steigerwald, 'Central Counterparty Clearing and Systemic Risk Regulation' in Anastasios G Malliaris and William T Ziemba (eds), *The World Scientific Handbook of Futures Markets* (World Scientific Publishing Co Pte Ltd 2015).

regard, CCPs have the potential to achieve both objectives, provided that adequate risk management and controls are in place.[123]

2.4 Useful Concepts in the Regulation of Central Counterparties: Understanding the Framework and Impact in Financial Services

2.4.1 Central Counterparty (CCP)

When a CCP is introduced between the parties involved in financial transactions across various markets, it assumes the role of the buyer for every seller and the seller for every buyer, establishing a principal-to-principal relationship.[124] It is important to note that in many markets, the choice to utilize CCP clearing remains optional for the trading parties, while in some cases, CCP clearing is mandatory for eligible instruments.[125]

The distinctive position of CCPs in the markets has played a significant role in the increasing success of the CCP clearing concept, especially in recent years.[126] By replacing the original trading counterparty, CCPs facilitate the growing trend of anonymous trading. This is because, through CCP clearing, the CCP becomes the counterparty for all processed trades.[127] Consequently, market participants bear an equal counterparty risk concerning these cleared trades.[128] Without a CCP, disclosing the

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[123] Jo Braithwaite and David Murphy, 'Central Counterparties (CCPs) and the Law of Default Management' (2017) 17 Journal of Corporate Law Studies 291.
[124] Committee on Payment and Settlement Systems (CPSS) and Technical Comittee of International Organization of Securities Commissions (IOSCO), 'Recommendations for Central Counterpaties' (2004).
[125] Glass (n 106).
[126] Gregory (n 107).
[127] Darrell Duffie and Zhu Haoxiang, 'Does a Central Counterparty Reduce Counterparty Risk?' (2011) 1 The Review of Asset Pricing Studies 74.
[128] ibid.

identity and account of the original counterparty becomes necessary for transactions to be promptly and accurately processed and settled.[129]

2.4.2 Clearing

The term clearing, initially associated with administrative tasks, now primarily refers to the calculation and validation of mutual obligations between market participants.[130] However, the usage of this term is frequently misused and lacks a consistent definition.[131] For example, it is commonly employed to encompass all activities occurring between trading and settlement when referring to post-trade processes as "clearing and settlement".[132] In its basic form, clearing occurs multiple times at different stages within a trade cycle, involving various intermediaries, to ensure the smooth processing of a trade.[133]

On the other hand, concerning securities markets, clearing pertained to the confirmation, calculation, and harmonization of obligations between trading counterparts.[134] However, with the beginning of CCPs, clearing has extended its scope to encompass CCP clearing in certain instances.[135] The aspect that can be puzzling is that within a trade cycle, different entities may perform the same processes, such as matching and confirming a transaction.[136]

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[129] Joanna Benjamin, *Financial Law* (Oxford University Press 2007).
[130] Randy Priem, 'Distributed Ledger Technology for Securities Clearing and Settlement: Benefits, Risks, and Regulatory Implications' (2020) 6 Financial Innovation.
[131] Huang, The Law and Regulation of Central Counterparties (n 108).
[132] ibid.
[133] David Loader, *Clearing and Settlement of Derivatives* (Elsevier 2005).
[134] Tina P Hasenpusch, *Clearing Services for Global Markets* (Cambridge University Press 2009).
[135] Dietrich Domanski, Leonardo Gambacorta and Cristina Picillo, 'Central Clearing: Trends and Current Issues' [2015] BIS Quarterly Review 59.
[136] Balmer (n 104).

Nevertheless, the concept of clearing, as it pertains to CCPs, differs significantly from its general meaning, which simplistically refers to matching and confirming transactions. More precisely, in the context of CCPs, clearing focuses on functions such as risk management, position management, collateral management, and delivery management.[137] In the modern post-trade infrastructure that involves CCP clearing, the process of CCP clearing occurs before the clearing performed by Central Securities Depositories (CSDs).[138]

It is crucial to distinguish between the clearing services provided by CCPs to their members and the services provided by members to other participants who are not CCP members. While CCP members offer services like confirmation and account maintenance, some members with extensive client bases may occasionally be able to offset obligations for their clients within their own systems.[139] For example, if two equal and opposite transactions involving the same class of securities are executed by the member's clients, the member may offset these obligations.[140] However, it is important to note that these members do not have the authority to determine such balances, and their actions do not hold the same legal capacity as a CCP.[141]

2.4.3 Settlement

Prior to the implementation of book-entry systems, securities transactions were settled by physically delivering paper-based securities, requiring

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[137] Kristin N Johnson, 'Governing Financial Markets: Regulating Conflicts' (2013) 88 Washington Law Review 185.
[138] Koen Vanderheyden and Tim Reucroft, 'Central Securities Depositories Regulation: The next Systemic Crisis Waiting to Happen?' (2015) 7 Journal of Securities Operations & Custody, 242.
[139] Henry F Minnerop, 'The Role and Regulation of Clearing Brokers-Revisited.' (2020) 75 Business Lawyer 2201.
[140] ibid.
[141] Johnson (n 137).

labor-intensive manual processes.[142] The exponential growth in trading volume eventually rendered the physical exchange unmanageable, resulting in the well-known paperwork crisis in the United States during the 1970s.[143] In response to this crisis, securities settlement systems transitioned to electronic-based systems, aiming to enhance transaction processing efficiency.[144] This shift was largely facilitated by technological advancements, particularly rapid and secure distributed network technology.[145] Additionally, initiatives were taken to shorten the trade processing cycle, with the ultimate objective of achieving real-time processing.[146] These developments have played a crucial role in meeting the increasing demands for efficiency in securities transactions.

Monetary and non-monetary obligations must be fulfilled according to the agreed-upon terms, including in securities trading. In its most basic form, the settlement of an individual securities transaction involves two systems: a payment settlement system for transferring funds and a securities settlement system for transferring securities.[147] After each settlement cycle is completed, the trading positions are reflected in the systems' accounts, as commonly seen in modern book-entry systems.[148] Consequently, the buyer's account in the payment system is debited and

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[142] Kenneth D Garbade, 'Origins of the Federal Reserve Book-Entry System' [2004] Federal Reserve Bank of New York (FRBNY) Economic Policy Review 33.
[143] Wyatt Wells, 'Certificates and Computers: The Remaking of Wall Street, 1967 to 1971' (2000) 74 The Business History Review 193.
[144] ibid.
[145] Charles R Geisst, 'Bear Market (1970–81)' in Charles R Geisst (ed), *Wall Street. A History* (Oxford Scholarhip Online 1999).
[146] ibid.
[147] Committee on Payment and Settlement Systems, 'The Interdependencies of Payment and Settlement Systems' (2008) 84.
[148] Changmin Chun, *Cross-Border Transactions of Intermediated Securities. A Comparative Analysis in Substantive Law and Private International Law* (Springer 2012).

the seller's account is credited, while the reverse occurs in the securities settlement system.

In a standard market, transactions that undergo matching and validation within a settlement cycle need to be cross-referenced with their corresponding account holdings to complete the final settlement in the settlement systems.[149] Purchasing parties requiring payment must have sufficient credit in the settlement accounts of the relevant payment system. Delivering parties must have the necessary securities available before the settlement processing commences. However, some buyers and sellers of securities do not maintain accounts directly at the Central Securities Depository (CSD); instead, they opt to employ an intermediary/custodian to handle the custody of their securities and facilitate the settlement of their trades.[150] The custodian may further delegate the responsibility of holding their clients' securities to a sub-custodian.[151] The real-time connection between payment systems and securities settlement systems enables the implementation of the Delivery Versus Payment (DVP) mechanism.[152] Nevertheless, this interconnection also means that a lack of adequate credit or securities will clearly result in the failure of the trade settlement.

Furthermore, the process has become more complex due to the introduction of modern indirect-holding structures for book-entry securities.[153] In such systems, settlement for securities transactions can

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[149] Daniela Russo and others, 'Governance of Securities Clearing and Settlement Systems' (2004) 21.
[150] Eddy Wymeersch, 'Central Securities Depositories and Reform of the Settlement Process' (2021) 14 Journal of Securities Operations & Custody 13.
[151] ibid.
[152] Marysue Fisher, 'Legal Issues Regarding Payment and Settlement' in Robert C Effros (ed), *Current Legal Issues Affecting Central Banks* (Volume IV, International Monetary Fund 1997).
[153] Wymeersch, 'Central Securities Depositories and Reform of the Settlement Process' (n 150).

occur through various methods. Typically, the securities transactions are settled within the books of the CSD operator.[154] In certain cases, where market regulations allow, securities settlement can be internalized.[155]

On the other hand, securities settlement systems are primarily designed to cater to their respective national markets. Hence, they are frequently characterized by high centralization or monopolization at the national level.[156] Currently, the system incorporates a CSD as a core component, functioning based on a membership model.[157] Due to the relatively high cost of membership and the requirement for members to consistently meet strict criteria, the system sees only a limited number of institutions directly engaging in participation.[158] As a result, other participants can solely access the system indirectly through these direct participants.

These differences can determine the type of securities settlement system. Considering the way each trade is settled, securities settlement systems can be gross or net whereas depending on the type of processing, the settlement system can also be either that of continuous settlement or batch settlement.[159]

2.4.4 Over-the-Counter (OTC) Market

Derivatives are financial agreements whose value is connected to the price of an underlying asset, rate, index, or event.[160] The term

[154] Ruben Lee, *Running the World's Markets. The Governance of Financial Infrastructure* (Princeton University Press 2010).
[155] ibid.
[156] Brian Scott-Quinn and William Walmsley, *New Frontiers in Clearing and Settlement* (International Securities Markets Association 1999).
[157] Vanderheyden and Reucroft (n 138).
[158] Delphine Nougayrède, 'Towards a Global Financial Register? The Case for End Investor Transparency in Central Securities Depositories' (2018) 4 Journal of Financial Regulation 276.
[159] Huang, The Law and Regulation of Central Counterparties (n 108).
[160] Randall Dodd, 'The Structure of OTC Derivatives Markets' (2002) 9 *The Financer*.

"derivative" signifies that the price of these contracts is derived from the price of an underlying asset or the occurrence of an event.[161] It encompasses various financial instruments such as futures, forwards, options, and swaps.[162]

Derivatives are traded in two types of markets: exchanges and over-the-counter (OTC) markets. Exchanges have historically involved "pit" trading using open outcry, but electronic trading platforms have now been adopted by exchanges, which match bids and offers automatically to execute trades in a multilateral setting.[163] Trading derivatives on exchanges, typically futures and options, is conducted through brokers rather than dealers.[164]

Certain scholars have contended that the impact of CCPs is more pronounced in derivatives markets compared to their role in clearing securities transactions.[165] In the bilateral OTC derivatives market, participants rely on the creditworthiness of their counterparties, exposing them to credit risk, namely the risk of counterparty default.[166] Consequently, market participants must actively monitor their counterparties to assess credit risk and determine the necessary collateral requirements.[167]

CCPs operating in the OTC derivatives market aim to address information asymmetries by facilitating the availability of information to both market

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[161] Eleni Tsingou, 'The Governance of OTC Derivatives Markets' in Peter Mooslechner, Helene Schuberth and Beat Weber (eds), *The Political Economy of Financial Market Regulation. The Dynamics of Inclusion and Exclusion* (Edward Elgar Publishing 2006).
[162] Robert G Pickel, 'Navigating the Financial Crisis: Choosing the Right Path for the Derivatives Industry' (2009) 4 Capital Markets Law Journal S69.
[163] Manmohan Singh, 'Collateral, Netting and Systemic Risk in the OTC Derivatives Market' IMF Working Paper, WP/10/99.
[164] ibid.
[165] Hasenpusch (n 134).
[166] Weber, 'Central Counterparties in the OTC Derivatives Market from the Perspective of the Legal Theory of Finance, Financial Market Stability and the Public Good' (n 112).
[167] ibid.

participants and regulators through trade repositories.[168] The lack of transparency in the exposure of key market participants to one another was identified as a factor contributing to self-protective behavior and a rapid decline in market liquidity during the global financial crisis.[169] However, by acting as a single counterparty, CCPs have the ability to distribute losses widely across the market, thereby mitigating concerns related to information asymmetry.[170] Additionally, the presence of a clearinghouse expedites the payout process for creditors and enables swift resolutions outside the scope of bankruptcy proceedings.[171] This approach helps bypass the complexities and scale of insolvency procedures, while reducing the impact of illiquidity and uncertainty.[172]

The effective management of systemic risk relies on the participation of a diverse range of clearing members who are not highly correlated.[173] However, becoming a clearing member entails meeting stringent criteria, leading to the formation of a select group of systemically significant participants.[174] Consequently, when a clearing member defaults, their positions are distributed among a relatively small number of clearing members, which can potentially strain their financial stability.[175] It is important to acknowledge that CCPs do not eliminate counterparty risk

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[168] Heath and others (n 24).

[169] Emilios Avgouleas, 'The Global Financial Crisis, Behavioural Finance and Financial Regulation: In Search of a New Orthodoxy' (2009) 9 Journal of Corporate Law Studies 23.

[170] Szpringer and Szpringer (n 105).

[171] European Central Bank (ECB), 'Central Counterparty Clearing Houses and Financial Stability' [2005] Financial Stability Review 177.

[172] Jens-Hinrich Binder, 'Central Counterparties' Insolvency and Resolution – The New EU Regulation on CCP Recovery and Resolution' in Jens-Hinrich Binder and Paolo Saguato (eds), *Financial Market Infra- structures: Law and Regulation* (Oxford University Press 2021).

[173] Braithwaite (n 45).

[174] European Securities and Markets Authority (ESMA), 'Clearing Obligation and Risk Mitigation Tecniques under EMIR' (n 34).

[175] Randy Priem, 'CCP Recovery and Resolution: Preventing a Financial Catastrophe' (2018) 26 Journal of Financial Regulation and Compliance 351.

but instead concentrate it.[176] This highlights the interconnected nature of the clearing system, which remains linked to the non-cleared sector, and where CCPs and financial firms maintain interdependencies.[177] Notably, the OTC and Exchange Traded (ET) derivatives markets are interconnected since many financial institutions engage in simultaneous trading in both markets to manage their positions effectively.[178] As a result, CCPs operating in the OTC derivatives market function within a highly interlinked market environment.[179]

It can be illustrated with an example, Country X is a third-country, which is not a member of the EU. Now, we have a financial institution based in the EU: EuroBank, and another institution in Country X, named GlobalFinance. EuroBank wishes to engage in an Over-The-Counter (OTC) derivative transaction with GlobalFinance. In this case, EuroBank wants to hedge its currency risk, and GlobalFinance is willing to offer the required derivative instrument. However, for EuroBank to engage in this OTC transaction, it needs to clear it through a CCP that is recognized by the EU regulatory authorities. Country X does not have its own recognized CCP, so GlobalFinance seeks to use a third-country CCP based in Country Y, which has received equivalence recognition from the EU. Let's call this CCP "GlobalCCP." In this fictional example, EuroBank can enter into the OTC derivative transaction with GlobalFinance because GlobalCCP is recognized by the EU as an equivalent CCP. This recognition ensures that EuroBank can clear the OTC derivative with GlobalFinance through

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[176] Christian Chamorro-Courtland, 'Counterparty Substitution in Central Counterparty (CCP) Systems' (2010) 26 Banking and Finance Law Review 520.
[177] ibid.
[178] Eva Hüpkes, 'Too Big, Too Interconnected and Too International to Resolve? How to Deal with Global Financial Institutions in Crisis' in Panagiotis Delimatsis and Nils Herger (eds), *Financial Regulation At the Crossroads: Implications for Supervision, Institutional Design and Trade* (Kluwer Law International 2011).
[179] Lucia Quaglia and Aneta Spendzharova, 'Disentangling Derivatives: International Policy Reforms Concerning Central Counterparties' (2022) 25 Journal of Economic Policy Reform 305.

GlobalCCP, even though Country X is a third-country outside the EU. This example highlights the importance of equivalence recognition in enabling cross-border financial transactions involving third-country CCPs within the EU's regulatory framework.

2.4.5 Indirect-Holding Structure

The fundamentals of indirect/tiered account-holding structures are highly important for comprehending the trade processing involved in modern financial markets. Due to the distinctive and significant role of intermediation within book-entry systems, it is probable that multiple intermediaries exist in the link between the investor and the central depository.[180] However, settlement system operators often find it impractical to offer direct access to all participants. By contrast, they typically have a restricted number of direct members or account holders, while the majority of other participants gain access indirectly through intermediaries who themselves are direct members of the systems.[181]

In the indirect holding system, securities issuers typically register the ownership of their securities under the name of one or multiple depository intermediaries.[182] While physical certificates are available for the majority of securities held via a depository intermediary, these certificates are retained by the intermediary and are not transferred to third parties.[183]

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[180] Thomas Keijser and Charles W Mooney Jr., 'Intermediated Securities Holding Systems Revisited: A View Through the Prism of Transparency' [2019] Penn Carey Law: Legal Scholarship Repository.

[181] Mario Guadamillas and Rober Keppler, 'Securities Clearance and Settlement Systems: A Guide to Best Practices' [2001] World Bank Research Working Paper Series 1.

[182] Fei Nie and Mahmood Bagheri, 'A Comparison of Investors' Protection in Different Securities Holding Systems and the Legal Implications of Direct and Indirect Holding: A Focus on China's Central Securities Depository Legal Position' (2021) 16 Capital Markets Law Journal 187.

[183] Steven L Schwarcz, 'Intermediary Risk in a Global Economy' (2000) 50 Duke Law Journal 1541.

The depository intermediary maintains a record of the identities of other intermediaries, such as brokerage firms or banks, that have acquired interests in these securities.[184] In turn, those additional intermediaries document the identities of investors who acquire interests in the intermediaries' holdings.[185] Within this framework, the rights of the end investor concerning the securities are no longer indicated by registration in the issuer's register or direct ownership.[186] Instead, these rights are represented through the investor's securities account held with the respective intermediary.[187] Nevertheless, at the highest level of this holding structure, a registrar or custodian maintains its own records of securities holders, each of whom possesses at least one account with the registrar or custodian.

2.4.6 Book-Entry Securities

In book entry securities systems, securities intermediaries are obligated to meet regulatory requirements for segregating assets, which involves, among other functions keeping their own assets separate from the assets of their clients.[188] Generally, a securities intermediary manages both external and internal securities accounts.[189] These securities accounts can be classified into two main categories: omnibus accounts and segregated accounts.[190] The primary differentiating factor between these two account

[184] Roy Goode, 'Intermediated Securities: The Long Haul to a Modern, Comprehensive Legal Structure' in Louise Gullifer and Jennifer Payne (eds), *Intermediation and Beyond* (Bloomsbury Academic 2019).
[185] ibid.
[186] Eva Micheler, 'Intermediated Securities from the Perspective of Investors: Problems, Quick Fixes and Long-Term Solutions' in Jennifer Payne and Louise Gullifer (eds), *Intermediation and Beyond* (Bloomsbury Academic 2019).
[187] ibid.
[188] Jr Hamilton F Potter, 'Introduction to Book Entry Transfer of Securities' (1972) 2 The Business Lawyer 209.
[189] ibid.
[190] Maria Vermaas, 'The Call for Proper Segregation in Intermediated Systems' (2013) 18 Uniform Law Review 589.

types is whether the intermediary separates the assets of one client from the assets of other clients.[191]

Furthermore, the implementation of book-entry securities, also known as security entitlements, raises inquiries about their practical and legal acquisition and transfer processes.[192] The process of acquiring book entry securities is closely linked to their transfer.[193] In this regard, there are at least three legal issues that need to be examined: the first pertains to the creation and acquisition of book entry securities; the second concerns the definition of a transfer within the context of the indirect holding system and lastly, there is the matter of remedies to be considered. These additional aspects fall beyond the scope of this dissertation; however, their importance should not be overlooked, particularly in the context of CCP regulation and the specific considerations surrounding third-country CCPs.

On the other hand, in order to enable efficient electronic trade settlement, securities need to be held in a book entry account, which is fundamentally different from the conventional paper-based securities.[194] The adoption of a book entry system may have minimal effect on registerable securities. Financial markets implemented techniques known as materialization and immobilization to support the indirect holding structure and streamline transaction settlement.[195] These methods, although distinct, serve the

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[191] ibid.

[192] Luc Thévenoz, 'Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law' (2008) 13 Stanford Journal of Law, Business and Finance 384.

[193] Chun (n 148).

[194] Pierre Francotte, 'Clearing and Settlement of Book-Entry Securities Transactions' in International Monetary Fund (ed), *Current Developments in Monetary and Financial Law* (International Monetary Fund Publication Services 1999).

[195] Alessandro V. Guccione, 'Necessary Reforms for Book-Entry Securities' in Elisabetta Gualandri, Gian Nereo Mazzocco and Roberto Bottiglia (eds), *Consolidation in the European Financial Industry* (Palgrave Macmillan 2010).

common purpose of enabling electronic transfers through the book entry system.[196] Materialization and immobilization differ in their treatment of paper-based securities. Immobilization involves removing paper securities from circulation and storing them in centralized depositories, while dematerialization eliminates paper entirely by replacing it with electronic records.[197]

The processes of immobilizing and dematerializing securities are essential for enabling efficient post-trade processing within the book-entry system. In practice, these steps involve transforming securities from physical certificates that need to be physically held into mere book-entry positions. However, from a legal standpoint, the implications of immobilization and dematerialization are significantly different and have far-reaching consequences.[198] The introduction of modern book entry securities fundamentally modifies the rights of investors who previously held an absolute right, which was well-established in law, as direct holders of negotiable instruments.[199]

2.5 Registration Process and Requirements in the European Union

CCPs differ substantially from CRAs in terms of regulation at the EU level. While CRAs have undergone more extensive regulation, the regulation of CCPs in the EU is comparatively less developed.

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[196] ibid.

[197] Marek Dubovec, *The Law of Securities, Commodities and Bank Accounts. The Rights of Account Holders* (Edward Elgar Publishing 2014).

[198] Setsuya Sato, Helen Allen and John Hawkins, 'Electronic Trading and Its Implications for Financial Systems' (2001) 7 BIS Papers 30.

[199] Christophe Bernasconi, 'The Hague Securities Convention' in International Monetary Fund (IMF), *Current Developments in Monetary and Financial Law* (Vol 5, International Monetary Fund Publication Services 2008).

Previously, EU CCPs were subject to supervision by authorities in their respective home countries, hence, it was predominantly the responsibility of each respective Member State within the EU while non-EU-based CCPs, known as third-country CCPs, were and still are, in some cases, supervised by their own home authorities.[200] The EU CCPs are authorized to operate in the EU by following the EMIR. Once, the CCPs are authorized, the ESMA publishes the new CCP in a list in accordance with Article 88(1) of EMIR.

In February 2009, the Larosiere Report, led by Jacques de Larosiere, put forth recommendations to strengthen financial market oversight in the EU financial sector.[201] The report suggested the establishment of European Supervisory Authorities to create a European System of Financial Supervision (ESFS).[202] The European Commission responded by expressing its intention to implement stricter regulations for the financial services market, particularly focusing on the OTC derivatives market, in order to mitigate the risk of future financial crises.[203] One significant regulatory measure that emerged from these objectives is the European Market Infrastructure Directive (EMIR).[204] EMIR, which has been in effect since August 2012, mandates the mandatory clearing of OTC derivatives through a central counterparty under certain conditions for both financial and non-financial counterparties.[205]

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[200] Douglas W Arner, 'Cross-Border Supervision of Financial Institutions' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (2015).

[201] Jacques de Larosière and others, 'The High-Level Group of Financial Supervision in the EU Report' (2009).

[202] ibid.

[203] Eric Helleiner, 'Reining in the Market. Global Governance and the Reguation of OTC Derivatives' in Dag Harald Claes and Carl Henrik Knutsen (eds), *Governing the Global Economy: Politics, Institutions and Economic Development* (Routledge 2011), 143.

[204] EMIR Regulation (n 5).

[205] Weber, 'Central Counterparties in the OTC Derivatives Market from the Perspective of the Legal Theory of Finance, Financial Market Stability and the Public Good' (n 112).

In the context of OTC derivatives, it is noteworthy to mention that prominent clearinghouses, including ICE Clear Europe and LCH.Clearnet, are legally structured as limited companies. By acting as a central counterparty (CCP) between transacting parties, the clearinghouse assumes the role of their respective counterparty, which helps mitigate default and monitoring risks that can then be transferred to end-users.[206]

3 Key Concepts in Financial Services Regulation: Insights and Implications

The concepts of systemic risk and the macroprudential approach are of utmost significance to this research, particularly in the post-financial crisis era. In response to the crisis, the EU has embraced a macroprudential perspective in its regulatory and supervisory measures to safeguard against systemic risks.[207] Given the critical roles of CCPs and CRAs in the financial markets, all the related measures pertaining to these services also adhere to the same approach.[208] The overarching goal is to ensure and maintain financial stability, preventing any potential threats.[209] As such, understanding these concepts is crucial in comprehending how the regulatory landscape has evolved to tackle potential risks and preserve the resilience of the financial sector.

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[206] Wendt (n 107).

[207] Rosa María Lastra, 'Systemic Risk and Macro-Prudential Supervision' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (Oxford University Press 2015).

[208] Tim Wittenberg, 'Regulatory Evolution of the EU Credit Rating Agency Framework' (2016) 16 European Business Organization Law Review 669; Albert J Menkveld, 'Monitoring CCP Exposure, in Real Time If Needed' in Douglas D Evanoff and others (eds), *Achieving Financial Stability: Challenges to Prudencial Regulation* (World Scientific Publishing Co Pte Ltd 2017).

[209] Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21).

3.1 Systemic Risk

In the aftermath of the financial crisis, a top priority for policymakers was to address systemic risk, which involved identifying and neutralizing threats to financial stability.[210] Systemic risk, also known as macroprudential risk, aims to prevent not only future financial crises but also minor disruptions in the smooth functioning of specific financial markets or sectors.[211] This approach stands in contrast to the traditional microprudential regulation that primarily focuses on assessing the solvency of individual institutions.[212]

Critics have highlighted two main categories of issues with the pre-crisis systemic risk regulation.[213] Firstly, there was an inadequate regulatory authority to effectively identify or mitigate systemic risk, partly due to the lack of transparency in financial markets.[214] Secondly, the regulatory structure itself had shortcomings that hindered regulators from successfully recognizing and responding to systemic risks, making it challenging to address potential vulnerabilities in the financial system.[215]

[210] Moloney, 'Financial Services and Markets' (n 22).
[211] Michael E Drew, 'The Future of Financial Regulation. Lessons from the Global Financial Crisis' (2010) 19 Griffith Law Review 50.
[212] Ferrarini and Saguato, 'Regulating Financial Market Infrastructures' (n 120).
[213] Jaime Caruana, 'Regulatory Stability and the Role of Supervision and Governance Keynote Address at the Tenth High-Level Meeting on Global Banking Standards and Supervisory Priorities in the Americas, Jointly Organised by the ASBA, BCBS and FSI (28 October 2015)' (2015); Carolyn Sissoko, 'Taking Asymmetric Information Seriously: What Modern Regulators Can Learn from the Structure of the London Stock Exchange in the Early Twentieth Century' (2015) 10 Capital Markets Law Journal 80.
[214] Dao, Godwin and Ramsay (n 23).
[215] Barry Eichengreen, 'International Financial Regulation after the Crisis' (2010) 139 Daedalus on the Financial Crisis & Economic Policy 107.

3.2 Macroprudential Approach

As initially conceptualized, macroprudential refers to a particular approach or standpoint within regulatory and supervisory frameworks.[216] This entails adjusting regulations and measures from a broad system-wide perspective, taking into account the overall system and its interconnections, rather than focusing solely on the safety and stability of individual institutions in isolation.[217] This approach involves starting with a top-down view and determining the appropriate safety standards for the entire financial system.[218] From this comprehensive perspective, the safety standards for individual institutions are derived accordingly. Additionally, it takes into consideration the crucial fact that risk drivers are dependent on the combined actions of financial institutions (endogenous), and not external factors beyond their control (exogenous).[219] The immediate aim of employing a macroprudential approach in regulation and supervision is to minimize the likelihood of widespread financial crises.[220] The ultimate purpose, however, is to prevent or minimize the adverse effects these crises can have on the real economy, such as output losses and other associated costs.[221]

[216] MD Knight, 'Marrying the Micro and Macroprudential Dimensions of Financial Stability: Six Years on BIS Speech 14th International Conference of Banking Supervisors, Mérida (4-5 October 2006)'; Claudio Borio, 'Towards a Macroprudential Framework for Financial Supervision and Regulation?' (2003) 128 BIS Working Papers 181.
[217] Andrew D Crockett, 'Marrying the Micro- and Macroprudential Dimensions of Financial Stability. BIS Speeches' (2000).Bank for International Settlements (BIS), '79th Annual Report' (2009).
[218] Claudio Borio, 'Implementing a Macroprudential Framework: Blending Boldness and Realism BIS Papers (22 July 2010)'.
[219] Piet Clement, 'The Term "Macroprudential": Origins and Evolution' (2010) March BIS Quarterly Review 59.
[220] Ivo Maes, 'On the Origins of the BIS Macro-Prudential Approach to Financial Stability: Alexandre Lamfalussy and Financial Fragility' (2009) 176 NBB Working Papers 1.
[221] Jaime Caruana, 'The International Policy Response to Financial Crises: Making the Macroprudential Approach Operational BIS Speech (21 August 2009)'.

3.3 The Relation of CRAs with Systemic Risk and Macroprudential Measures

CRAs are closely linked to macroprudential measures and systemic risk, as CRAs play a significant role in the financial system's stability and risk assessment and its lack of regulation were significant during the financial crisis.[222] Current regulation of CRAs is intended to address potential systemic risks that may arise from their activities and to ensure their sound functioning within the financial markets.[223]

Since credit ratings influence investment decisions and can impact the overall stability of financial markets, inaccurate or flawed credit ratings can lead to mispricing of assets, potentially contributing to systemic risks. Therefore, regulatory oversight of CRAs is essential to ensure the accuracy and reliability of their ratings, which in turn helps promote financial stability. For this reason, the regulatory framework for CRAs in the EU takes a macroprudential approach that includes requirements for transparency, independence, and internal controls.[224]

Moreover, the EU standards aim to reduce overreliance on credit ratings in the financial system because during the global financial crisis, there was excessive reliance on them, which contributed to the mispricing of assets and amplified systemic risks.[225] As a result, EU regulations

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[222] Partnoy (n 49).

[223] Iris HY Chiu, 'Regulatory Governance of Credit Rating Agencies in the EU: The Perils of Pursuing the Holy Grail of Rating Accuracy' (2013) 4 European Journal of Risk Regulation 209.

[224] Ana Fiorella Carvajal, 'An Assesment of Markets and Credit Rating Agency Regulation' in Charles Enoch and others (eds), *From Fragmentation to Financial Integration in Europe* (International Monetary Fund Publication Services 2014).

[225] Gudula Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (2014) 25 European Business Law Review 207.

encourage investors and financial institutions to conduct their due diligence and not solely rely on credit ratings for risk assessment.[226]

Furthermore, macroprudential measures can also impact CRAs in third countries, as they may need to adjust their practices and adhere to EU-mandated standards to maintain equivalence or seek recognition for regulatory purposes. This alignment with EU regulations could result in extraterritorial implications and will be studied in Chapter III and VII.

3.4 The Relation of CCPs with Systemic Risk and Macroprudential Measures

CCPs are closely intertwined with macroprudential measures aimed at mitigating systemic risk in the EU financial system, just as CRAs are. As cornerstones of the financial services industry, both CCPs and CRAs play critical roles in maintaining financial stability. CCPs play a critical role in reducing systemic risk by acting as central intermediaries in financial transactions, particularly in the clearing of OTC derivatives.[227] By providing central clearing services, CCPs help manage counterparty risks and reduce the potential for contagion in case of a default by a market participant.[228] This risk reduction function is particularly relevant for systemic risk, as it helps prevent the failure of one institution from spreading to others and causing broader financial instability.[229]

In the EU, CCPs are subject to a comprehensive regulatory framework that includes macroprudential measures designed to enhance their

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[226] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).
[227] Helleiner, 'Reining in the Market. Global Governance and the Reguation of OTC Derivatives' (n 203).
[228] Heath and others (n 24).
[229] ibid.

resilience and risk management capabilities.[230] Additionally, the EU's macroprudential approach to CCPs involves ongoing monitoring and supervision to assess and address potential systemic risks.

Despite the evident benefits of the macroprudential approach in safeguarding financial stability, it creates some challenges that need to be addressed. For instance, CCPs may face an increased regulatory burden as macroprudential measures may require them to meet additional requirements and standards to enhance their risk management capabilities, which can lead to higher compliance costs for CCPs. Moreover, meeting stricter liquidity and collateral requirements imposed to CCPs in the EU can affect the availability and cost of clearing services for market participants creating regulatory arbitrage.[231]

Moreover, macroprudential measures can also impact Central CCPs in third countries, as they may be required to harmonize their practices and adhere to EU standards to fulfill the prerequisites for accessing the EU single market. This aspect will be explored in greater detail in Chapter VII

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[230] Marco Dell'Erba, 'The Regulation of CCPs in Europe: The European Market Infrastructure Regulation (EMIR)' in Raphaël Douady, Clément Goulet and Pierre-Charles Pradier (eds), *Financial Regulation in the EU: From Resilience to Growth* (Palgrave Macmillan 2017).
[231] Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21).

CHAPTER III: THE GLOBAL REACH OF EU LAW IN THE FIELD OF FINANCIAL SERVICES THROUGH CRAS AND CCPS REGULATION

This section delves into the intricate relationship between the EU's approach to regulate third-country CCPs and CRAs and the broader concept of the global reach of EU law. However, within the scope of this chapter, the concept of the global reach of EU law serves as an encompassing term that involves various elements pertaining to the application of EU law beyond the borders of the EU. It includes not only extraterritoriality and territorial extension of EU law but also the resulting phenomenon known as the "Brussels Effect." By using this comprehensive framework, this research seeks to explore and analyze the multifaceted dimensions of third-country CRAs and CCPs' legal framework and its impact on a global scale.

The EU created a supranational legal and decision-making system in which the EU Member States cede some of their powers to EU institutions.[232] Consequently, the primary target recipients of EU law are the Member States. However, in some cases, EU law stretches to other territories beyond EU borders, expanding its scope of application to third countries.[233] This research intends to demonstrate that this is the case in CRAs and CCPs supervision and regulation. This dissertation has identified the global reach issue as one of the consequences of the equivalence and endorsement instruments used by the EU in its approach towards third country CCPs and CRAs.

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[232] Martina Schonard, 'Supranational Decision-Making Procedures' (*European Parliament*, 2021) <https://www.europarl.europa.eu/factsheets/en/sheet/8/supranational-decision-making-procedures>.

[233] L. Prete, 'On Implementation and Effects: The Recent Case-Law on the Territorial (or Extraterritorial?) Application of EU Competition Rules', 9 *Journal of European Competition Law & Practice* 2018, 487-495, at 487.

This chapter will delve into the main concepts, explaining the notions of extraterritoriality and territorial extension as essential forms of the extraterritorial reach of EU law. This conceptual foundation will set the stage for the research, enabling us to scrutinize their application and implications in a meticulous manner. Subsequently, it will examine the intriguing phenomenon known as the "Brussels Effect," a direct result of the extraterritorial reach of EU law. Moving forward, it will analyze specific provisions that develop extraterritorial influence in the regulation of third-country CRAs and CCPs. By exploring these provisions, this research aims to expose the reasons how this regulatory reach works and the scope of its impact. Moreover, it will trace the origins of this extraterritorial reach, searching its roots in the regulatory framework governing CRAs and CCPs. Then, it will explore the complex interaction between this reach, the EU's external relations, and the power of the single market, dissecting how these elements have shaped the regulatory landscape. Among these examinations, the pivotal dilemma emerges – the delicate balance between safeguarding domestic interests, fostering market openness, or prioritizing financial stability. This crucial dilemma will also be studied within the context of extraterritorial reach, illuminating the nuanced decisions faced by the EU in striking a harmonious equilibrium. Lastly, it will dive into the fascinating differentiation of extraterritorial reach, a variable determined by the specific third country involved. As we navigate through these chapters, each topic will be meticulously analyzed, uncovering the complications of the global reach of EU law in the field of CRAs and CCPs, ultimately revealing the implications for EU law, international finance, and the global financial ecosystem.

1 Literature Review

The concept of extraterritoriality and territorial extension represents significant aspects of the global reach of EU law. However, in the context of financial services, particularly concerning third-country CRAs and CCPs it has not been much discussed. Authors like Scott, Cremona and Davies have discussed about the global reach of certain measures in financial services in general in the EU.[234] Consequently, this research aims to explore the multifaceted implications of such global reach, while also examining the balance between safeguarding domestic interests, promoting an open market, and ensuring financial stability. The dilemma between these concepts has been studied by Fossum, Hoekman and Gross.[235] In fact, the position of the EU has been criticized for being considered "protectionist".[236] Consequently, this chapter delves into the

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[234] Scott, 'The New Extraterritoriality' (n 30); Paul Davies, 'Financial Stability and the Global Influence of EU Law' in Marise Cremona and Joanne Scott (eds), *EU Law Beyond EU Borders, the extraterritorial reach of EU Law* (Oxford University Press 2019); Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35); Scott, 'The Global Reach of EU Law' (n 33); Peter Behrens, 'The Extraterritorial Reach of EU Competition Law Revisited: The "Effects Doctrine" before the ECJ' (2016) 16 Europa Kolleg Hamburg Discussion Papers 1; Johan Schweigl, 'Extraterritorial Effects of EU Financial Markets Laws' in Nuno Cunha-Rodrigues (ed), *Extraterritoriality ofEU Economic Law* (Springer 2021); See more on extraterritoriality of financial regulation in the United States: John C Coffee, 'Extraterritorial Financial Regulation: Why E.T. Can't Come Home' (2014) 99 Cornell Law Review 1259; Matthias Lehmann, 'Legal Fragmentation, Extraterritoriality and Uncertainty in Global Financial Regulation' (2017) 37 Oxford Journal of Legal Studies 406; Erez Reuveni, 'Extraterritoriality as Standing: A Standing Theory of the Extraterritorial Application of the Securities Laws' (2010) 43 UC Davis Law Review 1071.

[235] John Erik Fossum, 'The EU and Third Countries: Consequences for Democracy and the Political Order' [2022] Journal of Common Market Studies 1; Bernard M Hoekman, 'The EU's Market Access Strategy : Does It Reach Its Main Goals?' (*European Parliament*, 2017) 6 <https://cadmus.eui.eu/handle/1814/54624>;Daniel Gross, 'The Economics of Brexit: It's Not about the Internal Market' (2016) 16 CEPS Commentary 1.

[236] Niamh Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making' (2011) 12 European Business Organization Law Review 41; Carl Fredrik Bergström, 'EU Rulemaking in the Internal Market after the Financial Crisis' in Carl Fredrik Bergström and Magnus Strand (eds), *Legal Accountability in EU Markets for Financial Instruments. The Dual Role of Investment Firms* (Oxford University Press 2021).Müller Patrick, Gerda

distinct mechanisms through which the global reach of EU law operates: territorial extension and extraterritoriality, and its effects on third countries. In this regard, authors like Feliu, Petrov and Delimatsis have studied how this influence is part of the EU's role as global actor.[237]

One key phenomenon illustrating the global reach of EU law is the "Brussels Effect." This concept, coined by Bradford, elucidates how the EU's regulatory standards extend beyond its borders due to its formidable market size and stringent regulations.[238] Consequently, non-EU countries often adopt EU-like standards to maintain access to the lucrative EU single market, thereby indirectly aligning their regulatory frameworks with EU norms. Christen and others, Gunst, and de Ville have studied how the Brussels Effect is present in other areas such as data protection and trade.[239]

Falkner and Zdenek Kudrna, 'EU–Global Interactions: Policy Export, Import, Promotion and Protection' (2014) 21 Journal of European Public Policy 1102.

[237] Laura Feliu and Francesc Serra, 'The European Union as a "Normative Power" and the Normative Voice of the European Parliament' in Stelios Stavridis and Daniela Irrera (eds), *The European Parliament and its International Relations* (Routledge 2015); Roman Petrov, 'The Dynamic Nature of the Acquis Communautaire in European Union External Relations' (2006) 18 Revue Européenne de Droit Public 741; Panagiotis Delimatsis, 'The Evolution of the EU External Trade Policy in Services-CETA, TTIP, and TiSA after Brexit' (2017) 20 Journal of International Economic Law 583; Marja-Liisa Öberg, 'Conclusion Internal Market – United in Everything but Membership ?' in Marja-Liisa Öberg (ed), *The Boundaries of the EU Internal Market Participation without Membership* (Cambridge University Press 2020); Anu Bradford, '1 How the EU Became a Global Regulatory Power?' in Anu Bradford (ed), *The Brussels Effect: How the European Union Rules the World* (2019). Ioanna Hadjiyianni, 'How Far Can the Extraterritorial Reach of EU Law Go? A Step Further by the CJEU as a Transnational Actor (19 May 2022)' (*European Law Blog*).

[238] Bradford, 'The Brussels Effect: How the European Union Rules the World' (n 36).

[239] Elisabeth Christen and others, 'The Brussels Effect 2.0: How the EU Sets Global Standards with Its Trade Policy' (2022) 7 FIW-Research Reports 1; Simon Gunst and Ferdi de Ville, 'The Brussels Effect: How the GDPR Conquered Silicon Valley' (2021) 26 European Foreign Affairs Review 437. Kai Purnhagen and Dominique Sinopoli, 'Reversed Harmonization or Horizontalization of EU Standards? Or: Does WTO Law Facilitate or Constrain the Brussels Effect?' (2016) 34 Wisconsin International Law Journal 92.

In the specific case of third-country CRAs and CCPs, the global reach of EU law is evident through provisions like equivalence and endorsement. Equivalence, as specified in EMIR (European Market Infrastructure Regulation) and CRA Regulation I, demands that third countries maintain regulatory rules equivalent to EU requirements. This ensures that CRAs and CCPs from these third countries can access the EU market while adhering to comparable standards. In this regard, Quaglia, Ferran and Moloney have exposed the consequences of equivalence in third countries.[240] Similarly, the endorsement mechanism permits non-EU CRAs to operate in the EU market after receiving a special endorsement from ESMA (European Securities and Markets Authority), a form of extraterritorial recognition. García-Alcubilla and Ruiz-del Pozo have studied the effects of endorsement as a mechanism independent from equivalence and its effects on the market.[241]

The origins of this global reach can be traced back to the EU's external relations policies and its power within the single market.[242] Jarlebring,

[240] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53); Scott James and Lucia Quaglia, '9 Brexit and the Future UK – EU Relationship' in Scott James and Lucia Quaglia (eds), *The UK and Multi-level Financial Regulation: From Post-crisis Reform to Brexit* (2020); Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53); Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26).

[241] Raquel García-Alcubilla and Javier Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU', *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (Oxford University Press 2013).

[242] Shawn Donnelly and Ramses Wessel, 'The International Dimension of EMU: The Interplay Between the Global Financial Stability Architecture and the European Union' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020); Jan Wouters and others (eds), *The Law of EU External Relations. Cases, Materials, and Commentary on the EU as an International Legal Actor* (3rd edn, Oxford University Press 2021); Frank Hoffmeister, 'The Contribution of EU Practice to International Law' in Marise Cremona (ed), *Developments in EU External Relations Law* (Oxford University Press 2008); Peter Van Elsuwege, 'The External Dimension of Joining and Leaving the EU' in Ramses A Wessel and Joris Larik (eds), *EU external relations law : texts, cases and materials* (Hart 2020).

Dür, Rabinovich, Petrov and Kalaitzake have intensively studied this phenomenon by indicating that the EU uses regulatory measures as leverage to encourage alignment with its rules.[243] This research proposes that the global reach in the field of CRAs and CCPs embodies this approach, with the EU's regulatory power indirectly shaping the policies of third countries.

On the other hand, this research argues that the differentiation in the global reach of EU law depends on the individual third country, taking into account their relationship with the EU, market relevance, and the strength of EU regulations.[244] Authors like Eisl, Kaeding and Milenković have

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[243] Johannes Jarlebring, '"Regime Vetting": A Technique to Exercise EU Market Power' [2021] Journal of European Public Policy; Roman Petrov, 'Exporting the Acquis Communautaire into the Legal Systems of Third Countries' (2008) 13 European Foreign Affairs Review 33; Andreas Dür, 'Fortress Europe or Open Door Europe? The External Impact of the EU's Single Market in Financial Services' (2011) 18 Journal of European Public Policy 619; Maryna Rabinovych, 'EU Free Trade Agreements as an Instrument of Promoting the Rule of Law in Third Countries: A Framework Paper' in Marc Bungenberg and others (eds), *European Yearbook of International Economic Law 2019* (Springer 2020). Manolis Kalaitzake, 'Brexit for Finance? Structural Interdependence as a Source of Financial Political Power within UK-EU Withdrawal Negotiations' (2021) 28 Review of International Political Economy 479.

[244] Ramses A Wessel, 'Friends with Benefits ? Possibilities for the UK ' s Continued Participation' (2019) 4 European Papers - A Journal on Law and Integration 427; Frank Schimmelfennig, Dirk Leuffen and Berthold Rittberger, 'The European Union as a System of Differentiated Integration: Interdependence, Politicization and Differentiation' (2015) 22 Journal of European Public Policy 764; Peter O'Shea, 'The Role of Transgovernmental and Transnational Dialogue in Financial Markets Cooperation' in Peter O'shea (ed), *Transatlantic Financial Regulation. US-EU Cooperation During the 2008 Financial Crisis* (Springer 2021); Benjamin Leruth, Stefan Gänzle and Jarle Trondal, 'Differentiated Integration and Disintegration in the EU after Brexit: Risks versus Opportunities' (2019) 57 Journal of Common Market Studies 1383; Guillaume Van Der Loo and Peter Van Elsuwege, 'Competing Paths of Regional Economic Integration in the Post-Soviet Space: Legal and Political Dilemmas for Ukraine' (2012) 37 Review of Central and East European Law 421; Nicolas Rennuy and Peter Van Elsuwege, 'Integration without Membership and the Dynamic Development of EU Law: United Kingdom v. Council (EEA)' (2014) 51 Common Market Law Review 935; R Daniel Kelemen, Anand Menon and Jonathan Slapin, 'Wider and Deeper? Enlargement and Integration in the European Union' (2014) 21 Journal of European Public Policy 647. Sandra Lavenex, 'Switzerland's Flexible Integration in the EU: A Conceptual Framework' (2009) 15 Swiss Political Science Review 547.

studied this differentiation from an economics perspective.[245] However, that research is useful for this since it can be applied from a legal perspective.

In conclusion, this chapter will study the multifaceted nature of the global reach of EU law, particularly in the realm of third-country CRAs and CCPs by analyzing existing literature from different fields but applied to a legal perspective. It will therefore, highlight the interplay between EU external relations, regulatory power, and market dynamics in shaping the extraterritorial effects. Furthermore, it will emphasize the necessity of balancing competing interests and the varied impact on different third countries, thus illuminating the intricate aspects of this vital regulatory issue as some authors like Kuner and Gstrein have indicated in other areas where EU law has global reach.[246]

2 Statement of the Problem: Exploring the Global Reach of EU Law through Equivalence and Endorsement

This study aims to comprehensively examine the regulatory implications of EU law on the legislation of CRAs and CCPs in third countries, with a specific focus on the mechanisms (endorsement and equivalence) enabling their access to the EU single market. The central research question seeks to understand how the EU's post-crisis regulatory measures, designed to facilitate the entry of third-country CRAs and CCPs into the EU market, impact the regulatory frameworks of these financial

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[245] Andreas Eisl, 'External Differentiation in Access to the Single Market: Effectiveness, Accountability and Political Unity' (2020); Michael Kaeding and Marko Milenković, 'External Differentiation: Turkey's Role in EU Agencies' (2021) 83 Robert Schuman Centre (RSC) Working Papers 1.

[246] Christopher Kuner, 'The Internet and the Global Reach of EU Law' in Marise Cremona and Joanne Scott (eds), *EU Law Beyond EU Borders: The Extraterritorial Reach of EU Law* (Oxford University Press 2019); Oskar Josef Gstrein and Andrej Janko Zwitter, 'Extraterritorial Application of the GDPR: Promoting European Values or Power?' (2021) 10 Internet Policy Review 1.

services in their respective non-EU jurisdictions and on a global scale. Hence, the study aims to assess the extent to which these regulatory provisions exhibit extraterritorial influence beyond the EU's borders. To accomplish this, the chapter will undertake a twofold inquiry. Firstly, it will examine how EU regulatory instruments established to enable third-country CRAs and CCPs to access the single market. Secondly, it will analyze the influence of these instruments on the regulation of these financial services in third countries and internationally and to what extent their regulation exhibit global reach.

3 Navigating Essential Concepts in the Regulation of CRAs and CCPs: Unraveling Global Reach, Extraterritoriality, Territorial Extension, and the Brussels Effect

3.1 Global Reach of EU Law in Financial Services. The Role of Territorial Extension and Extraterritoriality

The global reach of EU law refers to the impact and influence of EU legal principles and regulations beyond the geographical borders of the EU.[247] This phenomenon demonstrates the extensive reach and influence of EU law in shaping legal frameworks and practices worldwide. This reach is facilitated by the implementation of measures by the EU and its Member States, which can influence the adoption of legislation in third countries based on EU law.[248]

These measures can be categorized into two types: territorial extension and extraterritoriality. Territorial extension occurs when the EU suggests to third countries the implementation of specific rules within their own territories.[249] On the other hand, extraterritoriality comes into play when

[247] Scott, 'The Global Reach of EU Law' (n 33).
[248] Kuner (n 246).
[249] Scott, 'The Global Reach of EU Law' (n 33).

the EU demands compliance with its own laws and regulations outside its jurisdiction.[250] In this way, the EU's global reach rests on these key concepts and, to some extent, the so-called “Brussels Effect”.[251]

This approach has even been described as the EU's attempt to export its version of intensive multilateralism.[252] The exportation of EU law occurs through a regulatory framework for liberal markets that aligns with the EU's own model.[253] Some authors have emphasized the significant influence the EU has exerted beyond its borders, attributing it to three key factors closely tied to European integration:[254]

-The EU's Internal Market: The establishment and development of the EU's internal market have granted the Union substantial leverage in shaping global economic and public policy rules.

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[250] Bernadette Zelger, ‘EU Competition Law and Extraterritorial Jurisdiction–a Critical Analysis of the ECJ’s Judgement in Intel’ (2020) 16 European Competition Journal 613.
[251] Jarlebring introduced the concept of "regime vetting" as a way to describe the externalization of EU law. This term refers to the EU's assessment of non-EU countries' regulatory frameworks in specific areas, which can determine their access to the EU single market in those domains. Jarlebring's framework identifies four distinct types of regime vetting: coercive, assertive, supportive, and validating. These categories serve the purpose of maintaining a delicate equilibrium between the principles of free trade and the stringent policies upheld within the EU. The objective is to ensure that the regulatory practices of the EU's trading partners mirror the effectiveness of equivalent procedures within the EU itself. Although this research doesn't delve into this classification, it's noteworthy as the concept has gained prominence in recent literature, furthering the examination of the global reach of EU law, particularly from a regulatory perspective. Jarlebring (n 243).
[252] William Wallace, ‘Europe after the Cold War: Interstate Order or Post-Sovereign Regional System?’ (1999) 25 Review of International Studies 201; Katie Verlin Laatikainen and Karen E Smith, ‘Introduction — The European Union at the United Nations: Leader, Partner or Failure?’ in Katie Verlin Laatikainen and Karen E Smith (eds), *The European Union at the United Nations. Intersecting Multilateralisms* (Palgrave Macmillan 2006).
[253] Jean B Grugel, ‘New Regionalism and Modes of Governance - Comparing US and EU Strategies in Latin America’ (2004) 10 European Journal of International Relations 603.
[254] Frank Schimmelfennig, ‘EU External Governance and Europeanization Beyond the EU’ in David Levi-Faur (ed), *The Oxford Handbook of Governance* (Oxford University Press 2012), 657.

-The Eastern Enlargement: The enlargement of the EU to include Eastern European countries has played a crucial role in expanding the EU's reach and impact. As part of the accession process, these countries were required to align their legal systems with the entire acquis communautaire.

-Institutional Arrangements with Non-Member Countries: The EU has also developed institutional arrangements to manage interdependence and promote cooperation with neighboring countries that are neither EU members nor aspiring to join the Union.

On the other hand, a clear example of the global reach of EU law is competition law.[255] However, it is worth noting that the impact of EU law has not been limited to specific areas. Notably, this influence has been observed in the fields of data protection law and, more recently, securities law.[256] An illustrative example is the application of Regulation (EU) 2016/679, commonly known as the General Data Protection Regulation (GDPR), which enables the EU to enforce its data protection standards on non-EU data controllers and operators. In the field of securities law, Regulation (EU) No 648/2012, commonly known as the European Market Infrastructure Regulation (EMIR), has implemented clearing obligations for entities located in third countries engaging in cross-border transactions. The influence of EU law in this domain has brought about significant changes and developments, shaping regulations, market practices, and governance structures beyond the borders of the EU.[257]

[255] In 2017 the European Court of Justice through the case Intel used a qualified effects test to determine when competition law provisions can be applied and when the EU Commission has jurisdiction regarding competition law violations that involve third countries *Case C-413/14 P Intel/Commission* (2014) Intel/Comm. Hence, the qualified effects test was established to define jurisdictional limits, see more Robert Dover and Justin Frosini, 'The Extraterritorial Effects of Legislation and Policies in the EU and US' (2012).
[256] Scott, 'The Global Reach of EU Law' (n 33).
[257] Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32).

These instances serve as concrete illustrations of the expansive impact of EU law through territorial extension and extraterritoriality. This expansion highlights the far-reaching effects of EU law and the EU's pivotal role in shaping global standards and norms.

However, the global reach of EU law in financial services, as proposed in this research, presents some challenges, including the lack of consensus among international actors and the potential trade barriers that may impede the harmonization of international financial law. This situation arises because there are multiple existing international standards set by international organizations that may conflict with EU standards. Moreover, the European Court of Justice has not explicitly recognized the global reach of EU law, even as a spillover effect into the financial legislation of third countries. Additionally, the legal framework governing the third-country regimes is highly fragmented.[258] Furthermore, there is limited possibility for appealing certain decisions, and in the case of equivalence decisions, the EU retains the power to revoke a positive decision at short notice.[259]

On the other hand, a key question that arises when it comes to the global reach of EU law through territorial extension is whether this approach is equitable, particularly when considering the role of other international organizations responsible for CRAs and CCPs regulation, such as the IOSCO, G20, CPMI and the FSB.

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[258] Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53).

[259] Scott Morrison, 'International Company and Commercial Law Review Third-Country Equivalence : A Brexit Scenario for UK Financial Services' (2018) 29 International Company and Commercial Law Review 1.

3.2 Exploring the concept "The Brussels Effect" in the Regulatory Landscape of CCPs and CRAs

This research comprehensively examines the global reach of EU law by focusing on two specific instruments devised by the EU to facilitate access to the EU single market for third-country CRAs and CCPs: endorsement specifically designed for CRAs, and equivalence applicable to both CRAs and CCPs.

Through equivalence, the EU recognizes that the regulatory framework and supervision of CRAs and CCPs in a particular third country achieve similar outcomes and levels of investor protection as those required by EU law (See more in Chapter VI, Section 4.2).[260] This recognition enables market participants from that third country to access the EU market without the need for additional regulatory approval. Similarly, the concept of endorsement allows a credit rating issued by a third-country CRA to be relied upon in the EU market if it has been endorsed by an EU-registered CRA.[261] This endorsement signifies that the third-country CRA meets the standards and requirements set by EU law (See more in Chapter VI, Section 4.1).

In the context of equivalence and endorsement of CRAs and CCPs, the phenomenon known as the "Brussels Effect" is facilitated by the territorial extension and extraterritoriality of EU law. This effect is a direct result of the distinctive institutional framework and the strong internal market of the EU, which combine to produce a significant impact beyond its borders.[262] Furthermore, in this specific context, given the requirement for third countries to have regulatory and supervisory frameworks that

[260] Francesco Pennesi (ed), *Equivalence in Financial Services A Legal and Policy Analysis* (Palgrave Macmillan 2021).
[261] Stefan Loesch, 'Rating Agencies Regulation' (2018) 189 A Guide to Financial Regulation for Fintech Entrepreneurs 239.
[262] See Bradford 'The Brussels Effect: How the European Union Rules the World' (n 36).

are either "as stringent as" or "equivalent" to EU law concerning CRAs and CCPs, respectively, a concept elucidated by A. Bradford becomes pertinent. She introduces the concept of the de jure "Brussels Effect," which can be defined as the deliberate or unintentional employment of mechanisms that incorporate EU legislation into the legal systems of third countries.[263]

The EU's expanding regulatory influence has also provoked some criticism. Some authors have characterized the "Brussels Effect" as a form of "unilateral regulatory globalization".[264] This term captures the perception that the EU, through its regulatory actions and standards, can indirectly shape global norms and practices, even in the presence of international organizations in charge of the standardization. While proponents argue that the Brussels Effect reflects the EU's commitment to promoting its values and standards globally, critics argue that it may infringe upon the sovereignty of other nations and lead to unintended consequences. [265]

4 Analysis of EU Law Provisions with Potential Global Reach

4.1 CRAs

Concerning CRAs, the revised IOSCO Code served as a reference point for the European Commission's initial draft of the regulation on CRAs. Nonetheless, the Commission argued that the IOSCO rules needed to be more specific and enforceable.[266] In response to its regulatory needs, the EU devised a comprehensive framework to address the issue at hand,

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[263] ibid.
[264] Scott, 'The Global Reach of EU Law' (n 33); Bradford, 'The Brussels Effect: How the European Union Rules the World' (n 36).
[265] Christen and others (n 239).
[266] Lucia Quaglia, 'Financial Regulation and Supervision in the European Union after the Crisis' (2013) 16 Journal of Economic Policy Reform 17.

leading to the enactment of Regulation 1060/2009. This regulation was specifically crafted to subject previously unregulated markets and institutions to regulatory oversight in response to the crisis.[267]

In particular, Article 4 and 5 introduced endorsement and equivalence as mechanisms to enable the use of ratings from third-country CRAs for regulatory purposes in the EU to determine capital requirements for banks. The introduction of endorsement as a mechanism for CRAs was a novel addition.[268] This approach developed in Article 4 (3) accepts ratings from third-country agencies when these are endorsed by a European subsidiary.

Before an EU CRA can proceed with endorsing credit ratings, ESMA must conduct two distinct assessments: the first focuses on the legal and supervisory framework of the third country, as outlined in the Methodological Framework for Endorsement.[269] The second assessment concerns specific conditions related to the CRAs intending to endorse credit ratings.[270]

This mechanism places a significant burden on endorsing EU CRAs as they are responsible for ensuring that the third-country CRA meets all the necessary requirements established in Article 4(3)(b) of the CRA Regulation I. Furthermore, the endorsing CRA is required to inform ESMA

[267] Quaglia, 'Financial Regulation and Supervision in the European Union after the Crisis' (n 2).
[268] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[269] European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR' (n 6).
[270] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation' (n 13).

if it becomes aware that any of the conditions initially assessed by ESMA are no longer met.[271]

On the other hand, equivalence had already been established prior to CRA Regulation I. Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (2003) was the first to mention equivalence in this area.[272] CRA Regulation I established that the European Commission has the authority to issue an equivalence decision, affirming that the legal and supervisory structure of a third country guarantees that credit rating agencies authorized or registered in that third country adhere to legally binding criteria that mirror the provisions laid out in CRA Regulation I and are subject to proficient oversight.[273]

4.2 CCPs

In the context of CCPs, the concept of equivalence was initially introduced through EMIR, particularly within Article 25 which outlines the process for recognition of third-country CCPs. This article specifies that a CCP established in a third country is permitted to provide clearing services within the EU upon obtaining recognition from ESMA. The recognition will be authorized upon the adoption of an implementing act by the European Commission, confirming, among other criteria, that the legal and

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[271] ibid.

[272] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L 345/64 (Prospectus Directive).

[273] Article 5 Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

supervisory structures in the jurisdiction where the CCP is situated align with the EMIR-established prerequisites in Article 25(2)(a) of EMIR.[274]

There is another pivotal aspect that demands consideration within the realm of CCP equivalence, and that is the concept of comparable compliance. This provision was introduced with EMIR 2.2 through Article 25 (a) (3) and the Commission Delegated Regulation of 14 July 2020.[275] This factor holds substantial significance as it is related to the access of third-country CCPs into the EU market. Despite being deemed equivalent, relying solely on the regulation and supervision of the home country is insufficient. Consequently, direct supervision from the EU becomes imperative, introducing an extraterritorial element into the equation.[276]

Embedded within the selected mechanisms (equivalence and endorsement) is the global reach of EU law, a central theme of this research. By exploring the implications and consequences of these instruments, this research sheds light on the broader international influence of EU law in the field of securities law concerning CRAs and CCPs.

The global implications of a negative equivalence decision or the withdrawal of an endorsement rendered by the EU are worth examining to elucidate how these provisions have potential global reach. In such instances, where the EU determines that a third country's legal and

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[274] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).

[275] Regulation (EU) 2019/2099 Of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 [2019] OJ L 322/1 (EMIR 2.2); Commission Delegated Regulation (EU) supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the minimum elements to be assessed by ESMA when assessing third-country CCPs' requests for comparable compliance and the modalities and conditions of that assessment 14 July 2020 C (2020) 4895 final (Commission Delgated Regulation on Comparable Compliance).

[276] Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (n 108).

supervisory systems do not align with the required equivalence criteria, this results in the prohibition of CRAs and CCPs from that jurisdiction to access the EU single market.[277] This dilemma prompts the third country to contemplate amending its legislative framework and instituting amendments that harmonize with the pertinent EU legislation.[278] This scenario underlines the cross-border repercussions of EU law and the need for third-country jurisdictions to recalibrate their legal landscape to conform with EU standards.

This occurs as the EU undertakes the critical task of evaluating the legislation and conduct of third countries. This action constitutes territorial extension according to J. Scott's definition.[279] J. Scott defined most equivalence decisions regarding financial services as a result of territorial extension and not extraterritoriality, as these decisions are used as a condition for third-country participants to access the EU internal market.[280] Hence, a third country is presented with the opportunity to consider the adoption of financial legislation modelled after EU law.

These provisions for third countries provide less regulatory obligations if the third country can demonstrate that its regulations are equivalent.[281] Nevertheless, the EU unilaterally defines the procedures for determining equivalence. Although adopting international standards contributes to regulatory convergence, scholarly research highlights several instances where the EU deviates from these standards.[282] Consequently, the EU's

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[277] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).
[278] ibid.
[279] Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32).
[280] ibid.
[281] Marcin Szczepański, 'Understanding Equivalence and the Single Passport in Financial Services. Third-Country Access to the Single Market European Parliament Briefing (February 2017) PE 599.267'.
[282] Christen and others (n 239); Emil Nästegård, 'Equivalence Decisions in the EU and UK Financial Services Sectors Post-Brexit' (2022) 33 European Business Law Review

equivalence decisions often involve a “Brussels Effect”, with Australia as an example where divergence from EU rules is used as a rationale for withholding equivalence decisions (See more in Chapter VII, Section 2).

5 Disentangling the Mechanism of EU Law's Global Reach

5.1 The External Action of the EU: Shaping the Global Reach of EU Law

In the context of external actions abroad, the EU's general principles of conferral, sincere cooperation, effectiveness, institutional balance, and democracy play a similar role as they do within the EU.[283] These fundamental principles played a crucial role in establishing the EU as a significant international actor and provided the legal foundation for the Court of Justice of the European Union (CJEU) to ensure the lawful exercise of external competences by both the EU and its Member States.[284]

Consequently, the extension of the reach of EU law can be attributed to the EU's external mission as envisioned by Article 3(5) and 21 of the Treaty on the European Union (TEU).[285] These provisions emphasize the EU's objective of promoting its values and principles in its external relations, thereby exerting its influence beyond its territorial boundaries. Among these objectives is the EU's commitment to contributing to the

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463; Cremona, ‘Extending the Reach of EU Law: The EU as an International Legal Actor’ (n 35).

[283] Anne Thies, ‘General Principles in the Development of EU External Relations Law’ in Marise Cremona and Anne Thies (eds), *The European Court of Justice and External Relations Law. Constitutional Challenges* (Hart Publishing 2014).

[284] ibid.

[285] Ibid.; Art. 3(5) of Treaty on the European Union (TEU): ‘[i]n its relations with the wider world, the Union shall uphold and promote its values and interests...’ Consolidated version of the Treaty on European Union - Title I: Common Provisions - Article 3 (formerly Article 2 TEU) [2008] OJ C 115/17; Cremona, "Extending the Reach of EU Law: The EU as an International Legal Actor" (n 35).

international legal order, promoting the development of international law, and advocating for multilateral solutions to global challenges. Hence, the EU is able to project its legal framework through those objectives.

Thus, the manner in which the EU regulates various aspects within its borders can have profound implications for its engagement with the international community and the broader global context. This occurs because the law is an instrument to interact with third countries in the EU.[286] It could be stated that this is particularly evident in the field of CRAs and CCPs involving third countries, where the regulatory decisions taken within the EU can impact financial activities in other parts of the world.

On the other hand, the EU's regulatory influence has experienced a significant expansion on a global scale, leading to a notable evolution in the concept of the reach of EU law.[287] This transformation highlights the EU's increasing role as a regulatory powerhouse, shaping global norms and practices through its laws and regulations.[288] Hence, a significant and dynamic relationship exists between the internal legal framework of the European Union and its external action.[289] This dynamic interrelation between internal and external dimensions of financial services regulation influences the cautious approach taken by the EU in this field. [290] Balancing the need to regulate and protect the internal market while

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[286] Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35).
[287] ibid.
[288] Bradford, 'How the EU Became a Global Regulatory Power?' (n 237).
[289] Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35).
[290] Petrov, 'The Dynamic Nature of the Acquis Communautaire in European Union External Relations' (n 239).

engaging with third countries for international trade purposes requires careful consideration.[291]

In this context, legal scholars and authors have delved into the dual nature of law in relation to the EU's engagement with third countries.[292] Firstly, the EU's engagement with third countries in trading financial services can potentially disrupt the entire EU single market. Harmonizing regulations across member states is an ongoing challenge, and when third-country interactions are involved, it becomes essential to strike a balance between promoting competition and safeguarding the stability and integrity of the internal market. Secondly, the EU has international commitments and obligations to fulfill concerning international trade, including financial services. As a member of the global community, the EU must navigate its regulatory efforts in a manner that adheres to its international agreements while safeguarding its interests.

Authors have mentioned the double nature of law in this case because it acts as both a legal basis and an instrument to interact with third countries.[293] Through creating legislation and policies with an external dimension, the EU enhances its role as a global actor in international law.[294] Therefore, the EU also exercises its market power as an

[291] Marise Cremona and Päivi Leino-Sandberg, 'External Relations of the EU and Euro Area in the Field of EMU' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020).
[292] Chad Damro, 'Market Power Europe' (2012) 19 Journal of European Public Policy 682.
[293] Thies, 'General Principles in the Development of EU External Relations Law' (n 283); Jan Wouters and others, 'Personality and Powers of the EU' in Jan Wouters and others (eds), *The Law of EU External Relations* (Oxford University Press 2021); Stefan Griller, Walter Obwexer and Erich Vranes, *Mega-Regional Trade Agreements: CETA, TTIP, and TiSA: New Orientations for EU External Economic Relations* (Oxford University Press Scholarship Online 2017); Cremona and Leino-Sandberg (n 291).
[294] Davies (n 234).

international actor by exporting social and economic policies, not solely relying on laws.[295]

In addition to the actions mentioned earlier, the EU possesses various other means to engage with the world and assert its influence on the global stage. Particularly, one of the EU's significant methods of projecting external power is by leveraging its vast internal market to influence and shape global regulation.[296] The EU's internal market is one of the largest and most prosperous in the world, providing a vast economic space that encompasses hundreds of millions of consumers and businesses.[297]

Hence, recognizing the economic weight of its internal market, the EU strategically uses it as a powerful bargaining chip in its interactions with other countries and international organizations.[298] By opening its internal market to the world, the EU invites other nations and trading partners to align their regulations and standards with EU norms.[299] Countries seeking access to the EU market are often required to comply with the EU's stringent regulatory requirements, ranging from product safety standards to environmental protections.[300] In this way, the EU exerts considerable influence over global trade and commerce by effectively setting benchmarks and best practices that extend beyond its borders.[301] Hence, the EU's practice of setting high regulatory standards can encourage a "race to the top" among trading partners who aspire to access the lucrative EU market. As a result, many countries and regions strive to

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[295] Damro (n 292).
[296] ibid.
[297] Marja-Liisa Öberg, 'Autonomy of the EU Legal Order' in Marja-Liisa Öberg (ed), *The Boundaries of the EU Internal Market Participation without Membership* (Cambridge University Press 2020).
[298] Damro (n 292).
[299] Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35).
[300] Jarlebring (n 243).
[301] Christen and others (n 239).

harmonize their laws and regulations with EU standards, leading to the dissemination of EU norms into the international arena.[302]

This approach not only enhances the EU's economic influence but also contributes to its broader agenda of promoting values such as sustainability, consumer protection, and social responsibility on a global scale. By exporting its regulatory framework and promoting higher standards, the EU actively shapes the rules of the global economy.

Nevertheless, from an academic perspective, it could be argued that understanding how and when the EU intentionally leverages its internal sources of power to actively influence third-country regimes can be highly challenging due to the inherent political nature of such actions. Furthermore, some authors have pointed out that this complexity is exacerbated by the widespread fragmentation of certain areas of law within the EU.[303] As a result, identifying the specific mechanisms and objectives behind the EU's engagement with third countries becomes a complex task, and it requires a nuanced examination of the various legal frameworks and political dynamics at play.

For this research the exercise of the EU's market power is of paramount importance as it extends beyond traditional legal instruments and holds the capacity to influence the law. Consequently, while some policies may not take the form of regulations or possess binding effects, they can still play a significant role in advancing the global reach and impact of EU law.

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[302] Anne Thies, 'EU General Principles in External Relations: Shaping the EU as a Global Actor and Dealing with Its Accountability' in Katja S Ziegler, Päivi J Neuvonen and Violeta Moreno-Lax (eds), *Research Handbook on General Principles in EU Law. Constructing Legal Orders in Europe* (Edward Elgar Publishing 2022).

[303] Patrick, Falkner and Kudrna (n 236); Alasdair R Young, 'Liberalizing Trade, Not Exporting Rules: The Limits to Regulatory Co-Ordination in the EU's "New Generation" Preferential Trade Agreements' (2015) 22 Journal of European Public Policy 1253.

In this regard, the EU relies on constitutional law as the foundation for its external actions and the legal instruments that occasionally extend their impact to third countries and international regimes,[304] e.g., equivalence certifications and endorsements (See more in Chapter VI). However, this can lead to conflicts between EU constitutional and international law, as their functions may overlap. This raises additional complexities since the EU's legal system is not only influenced by international standards but also actively contributes to shaping them.[305]Thus, the interplay between EU constitutional law and international law is another crucial aspect of the EU's external engagement.

Overall, the EU's cautious stance towards financial services regulation is a response to the delicate balance it must maintain between promoting its internal market, fulfilling international commitments, and managing potential external impacts. This approach highlights the complexity of managing financial services in a globalized context and underscores the importance of considering both domestic and international implications in regulatory decision-making.

5.2 Criticism of the two instruments allowing global reach: endorsement and equivalence

The author recognizes that the EU's approach and the lack of clear definition in certain areas may pose a potential risk to the international convergence of financial regulation. This is because international organizations such as the IOSCO, the FSB, or the CPMI play a crucial role in setting global standards for CRAs and CCPs. However, the challenge arises when a third country, which previously received equivalence or

[304] Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35).
[305] Scott, 'The Global Reach of EU Law' (n 33).

endorsement from the EU, faces a situation where a decision is revoked due to updates in EU law, such as the case of CRAs. In these cases, the third country may be uncertain about which standards to apply, as it only has the possibility to modify its legal framework to align with the new EU standards. This situation can lead to an overlap between recommendations from international organizations and the regulatory requirements imposed by EU law. The potential ambiguity and conflicting obligations can create challenges for third countries in effectively implementing international financial regulation while complying with EU standards. While this dissertation focuses on specific aspects of the EU's approach towards third countries in financial services regulation, in particular, regulation concerning third-country CRAs and CCPs, it is important to acknowledge that the broader application of international financial regulation within the EU's law-making process has implications for this approach. The interplay between international standards, EU law, and the regulatory expectations placed on third countries requires further examination to ensure coherence, clarity, and consistency in the global financial regulatory landscape. By acknowledging and addressing these complexities, policymakers and stakeholders can work towards enhancing international convergence, reducing regulatory uncertainties, and promoting effective cooperation in the field of financial regulation on a global scale.

5.3 Balancing Between Protecting Domestic Interests, Ensuring Financial Stability, And Opening the EU Market

Some authors have argued that equivalence rules form the foundation of the EU's new regulatory approach towards third countries in the field of

financial services.[306] These rules have emerged as a fundamental component of the EU's regulatory attitude, shaping its interactions and engagements with non-EU jurisdictions. By establishing criteria for assessing the compatibility of third-country regulations with EU standards, equivalence rules serve as a mechanism to promote cooperation, market access, and regulatory alignment in the field of financial services.[307]

On the other hand, the EU has been criticized for its approach towards third countries in the financial services field is the use of specific instruments such as endorsement and equivalence decisions to restrict certain operators and activities from accessing the EU single market.[308] This approach has raised concerns and some authors have described this approach as a "protectionist intent" aimed at favoring EU national providers of financial services.[309] Such measures, intended to safeguard market stability and protect EU interests, have been subject to scrutiny due to their potential impact on market competition and the perception of unequal treatment among international participants.[310] It highlights the delicate balance between protecting domestic interests and fostering fair and open global markets in the realm of financial services resulting in an ongoing consideration of the interplay between cooperation and

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[306] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[307] Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11).
[308] Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53).
[309] Dür (n 243); Nicolas Verón, 'Financial Regulation: A New Fortress Europe' (Bruegel Blog Post, 2010) <https://www.bruegel.org/blog-post/financial-regulation-new-fortress-europe> accessed 28 November 2023; Cornelia Woll, ''Lobbying under Pressure: The Effect of Salience on European Hedge Fund Regulation' (2012) 51 Journal of Common Market Studies 555.
[310] Danny Busch, 'The Future of EU Financial Law' (2022) 17 Capital Markets Law Journal 52.

fragmentation in this context. Collaboration consistently stands out as the optimal choice.

Despite the inherent risks associated with the field of financial services, achieving cooperation among prominent participants remains a formidable challenge and the EU plays a crucial role in facilitating such cooperation. Not only does it engage as a participant in financial services transactions, but it also assumes the role of a supranational organization with the objective of contributing to global governance, particularly in the realm of global economic governance.[311]

6 Proposed Solution to Address the Challenges Posed by Global Reach

The global reach of EU law in this field has raised questions about whether the extraterritorial impact is unduly burdensome for international cooperation in the field of financial services, international trade,[312] and global financial stability.[313] Furthermore, concerns about extraterritorial application of financial law raised even before the implementation of relevant regulations for CRAs and CCPs.[314] It occurs because of the lack of univocal guidelines to apply endorsement and equivalence concerning

[311] Hans-Jürgen Bieling, 'EMU, Financial Integration and Global Economic Governance' (2006) 13 Review of International Political Economy 420.

[312] Some authors consider that the repeal of an equivalence decision is a barrier for market access. Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (n 108); Guido Ferrarini and Davide Trasciatti, 'OTC Derivatives Clearing, Brexit, and the CMU' in Danny Busch, Emilios Avgouleas and Guido Ferrarini (eds), *Capital Markets Union in Europe* (Oxford University Press 2018); Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11).

[313] Francesco Pennesi, 'Equivalence in the Area of Financial Services: An Effective Instrument to Protect Eu Financial Stability in Global Capital Markets?' (2021) 58 Common Market Law Review 39.

[314] Cremona, 'Extending the Reach of EU Law: The EU as an International Legal Actor' (n 35).

third-country CRAs and CCPs in the EU.[315] Therefore, scholars speculate on the implications of the role of the EU as standards setter in the field of financial services.[316]

Consequently, the global reach of EU law in this field should be carefully revised. Considering options for a more robust regulatory and supervisory framework for CRAs and CCPs in the EU, this dissertation suggests that instead of solely relying on an extraterritorial effect that adopts a power-based approach similar to the 'Brussels Effect', a more sustainable approach to the universal protection and promotion of global financial stability would be optimal. These strategies could be manifested through strengthened cooperation and traditional harmonization of legal frameworks, aiming to establish a broader international consensus around key regulatory principles, institutional requirements, as well as effective safeguards and remedies for those impacted by any misconduct related to credit ratings and financial market operations.

In essence, while the extraterritorial impact of EU law on CRAs and CCPs has been contested,[317] countries across the globe have already taken steps well in advance to enact and update their national laws to align with what can be considered as "arguably the world's best practice" meaning the IOSCO Code of Conduct 2015 for CRAs and the Principles For Financial Market Infrastructures for CCPs.[318] Therefore, when it comes to CRAs and

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[315] Francesco Pennesi, *A Proposal to Reform the EU Equivalence Regime* (Springer 2022).
[316] Eilís Ferran, 'Crisis-Driven Regulatory Reform: Where in the World Is the EU Going?' in Eilís Ferran and others (eds), *The Regulatory Aftermath of the Global Financial Crisis* (Cambridge University Press 2012); Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[317] Dieter Pesendorfer (ed), *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (Palgrave Macmillan 2020).
[318] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies (March 2015) FR05/2015' (n 5); Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS) (n 102).

CCPs, it would be more beneficial for financial stability and a correct promotion of European values if the EU continues to develop and uphold high standards already established by international organizations like IOSCO, while actively participating in international fora and engaging in multilateral conversations, provided that this allows for the establishment of governance frameworks based on shared values. Simultaneously, it is crucial to ensure effective and comprehensive enforcement of existing provisions within the territories of Member States in order to maintain credibility.[319] This is because relying only on the extraterritorial application of EU law is not an optimal strategy for a contribution to the international legal order, harmonization in financial regulation or financial stability. Instead, it can create bigger disintegration and crises.

On the other hand, due to the challenges in cross-border transactions and the difficulty of geographically locating certain financial services, the extraterritorial application of laws has become increasingly common.[320] In the case of third-country CCPs and CRAs services, cross-border supervision has been very problematic.[321] In cases of clashing rules and complex financial services, scholars have suggested two possibilities for the countries involved: to cooperate or confront.[322] The latter option can be detrimental to both countries and international trade in financial services. Therefore, fostering cooperation is essential. However, achieving effective cooperation has proven to be a challenging task especially when it concerns on the hand, a financial service that was partly

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[319] Evariest Callens, 'Recalibrating the Debate on MiFID's Private Enforceability: Why the EU Charter of Fundamental Rights Is the Elephant in the Room' (2020) 21 European Business Organization Law Review 759.
[320] Dover and Frosini (n 29).
[321] Georges S Baur, 'Square Pegs and Round Holes (Continued): Financial Market Surveillance Authorities and Internal Market Association' (2020) 22 Cambridge Yearbook of European Legal Studies 32.
[322] Prete (n 233).

responsible of the financial crisis in 2007-8 (CRAs) and on the other hand, a financial service that is being promoted at any cost because of its effectivity to reduce systemic risk (CCPs). In some cases, endorsement and equivalence decisions have proven to be more confrontational than cooperative.[323] In particular, this issue arises when the global reach of EU law lacks a clear focus on promoting EU values and instead emphasizes EU regulatory power.[324]

Furthermore, in certain cases such as third-country CRAs and CCPs, cooperation regarding the extraterritorial application of laws could be pursued to safeguard common interests, particularly in relation to global

[323] It refers to the refusal to extend an equivalence concerning Swiss stock exchanges in 2019. The EU had recognized the equivalence of the Swiss financial regulation on stock exchanges, as required by MiFID II. In December 2018 it was extended for six months until June 2019. Nevertheless, it expired and was not further extended. In this case, the European Commission considered previous Council conclusions of 28 February 2017 in which the establishment of a common institutional framework regarding the participation of Switzerland in the EU internal market was a precondition for further development in the EU-Switzerland sectoral approach. This decision has been debated as Switzerland has a strong legal framework on financial services which is designed to be compatible with EU legal standards. In fact, over recent years, various equivalence decisions had recognized Swiss legislation in financial matters. Nevertheless, in this case, the equivalence decision was clearly used politically as the European Commission not only evaluated the applicable supervisory, regulatory and enforcement regime of Swiss stock exchanges (which falls into the realm of EU territorial extension, as defined earlier) but also used the granting of equivalence as a condition for Switzerland to enter the market and for the EU to obtain the updated institutional framework agreement. The denial of extension of this equivalence decision had the exact opposite effect of achieving financial integration and stability as it not only denied access to the EU market but also entirely removed the possibility of an institutional framework agreement between the EU and Switzerland. In addition, Switzerland now prevents Swiss investment firms from trading Swiss companies' shares in EU trading venues. Switzerland's measures in response to the loss of equivalence are contributing to what is considered financial disintegration. See more Michael Baltensperger, 'The Consequences of Switzerland's Lost Equivalence Status' (*Bruegel Blog Post*, 2019) <https://www.bruegel.org/2019/07/the-consequences-of-switzerlands-lost-equivalence-status/> accessed 28 November 2023; Niamh Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (2020) 17 European Company and Financial Law Review 35.

[324] Gstrein and Zwitter (n 246).

financial stability.[325] This discussion has taken place previously at international level.[326] In the case of the EU, it has taken various positions on the extraterritorial application of norms, particularly concerning non-EU norms within EU territory.[327] These discussions have primarily focused on competition law rather than the financial services field.[328] Consequently, there is insufficient cooperation among countries, and the issue of extraterritoriality remains problematic due to the lack of agreed-upon application guidelines. In order to address these challenges and promote more effective cooperation, it is crucial for governments to reach consensus on the appropriate application of extraterritorial laws in the financial services sector. This would help facilitate smoother cross-border transactions and enhance international trade in financial services.

Genuine cooperation holds the potential to be a viable solution in a field that exhibits clear interdependence. The financial services sector plays a crucial role in the economy of countries and regions, making it a distinct field of regulation compared to others. Given its significance, effective regulation and prevention are critical to avoid crises and ensure stability. However, international cooperation faces inherent limits, primarily due to the absence of binding rules and robust international institutions with enforcement powers.[329] The lack of universally accepted and enforceable regulations hampers the harmonization of practices and creates inconsistencies in cross-border transactions. Similarly, the absence of solid international institutions with enforcement capabilities diminishes the effectiveness of cooperative efforts, as there is no central authority to

[325] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).
[326] Jennifer G Hill, 'Regulatory Cooperation in Securities Market Regulation: Perspectives from Australia' (2020) 17 European Company and Financial Law Review 11.
[327] Prete (n 233).
[328] Niamh Dunne, 'Between Competition Law and Regulation: Hybridized Approaches to Market Control' (2014) 2 Journal of Antitrust Enforcement 225.
[329] Dao, Godwin and Ramsay (n 23).

oversee compliance and resolve disputes. In this context, it becomes essential to explore whether the extraterritorial application of competition law can serve as a viable model for the field of financial services. Competition law has demonstrated the potential to foster international cooperation, promote fair practices, and ensure a level playing field in the global market.[330] By studying the successes and challenges of extraterritorial competition law application, valuable insights can be gained on how to enhance regulation and prevention in the financial services sector. By establishing comprehensive and enforceable regulations and learning from other fields like competition law, the potential for effective regulation and prevention can be achieved. This, in turn, contributes to financial stability and resilience, benefiting economies on a global scale.

In this regard, this research proposes a mutual recognition-based framework. Under this framework, participating states establish bilateral agreements in which they acknowledge the equivalence of each other's regulatory standards. This acknowledgment enables financial institutions from both jurisdictions to operate in the partner's market under a presumption of regulatory equivalence. Essentially, the regulatory requirements that have been deemed equivalent in one state are automatically recognized as meeting the standards of the other state, significantly reducing the administrative burden of scrutinizing and comparing regulatory regimes.

This approach holds the potential to enhance market access and cooperation between jurisdictions, as it avoids the need for a unilateral decision by one party to endorse or recognize the other's regulatory framework. Instead, the mutual recognition-based framework fosters a

[330] Zelger (n 250).

collaborative approach where both parties actively participate in establishing the terms of recognition. This can lead to greater transparency, as both jurisdictions are involved in shaping the regulatory equivalency criteria and in addressing any potential gaps or disparities in their respective regimes.

Moreover, mutual recognition-based arrangements can promote regulatory convergence over time. As jurisdictions engage in continuous dialogue to uphold the mutually recognized standards, they may find opportunities to align their regulations further, harmonizing their approaches to financial services oversight. This convergence can lead to greater consistency and compatibility between regulatory regimes, reducing the friction and complexities arising from disparities in standards.

7 Differentiation and Comparative Analysis. Exploring the Variations in Global Reach between Different Countries

The degree of interconnectedness between the EU and specific third countries exhibits considerable variation, leading to diverse consequences when evaluating the endorsement or equivalence of CRAs and Central Counterparties CCPs. These divergent effects on the global reach of EU regulatory measures result from the distinct circumstances and attributes of each individual country, resulting in a complex and multi-faceted issue. Additionally, this differentiation can potentially impact the EU's financial markets, given the significant presence of third-country CRAs and CCPs providing services that may experience sudden disruptions. This scenario is further compounded by the fact that a substantial number of these third-country suppliers originate from non-EU countries.

The relationship between the EU and each third country is unique, and this diversity has significant implications for the evaluation of CRAs or CCPs concerning endorsement, equivalence or the required cooperation arrangements to use such instruments. The interconnection between the EU and a third country can vary greatly, leading to different outcomes in terms of the applicability of regulatory mechanisms.

For some third countries, their financial services are deeply linked with the EU, and as a result, the endorsement or equivalence granted to their CRAs may have a broader extraterritorial impact. In contrast, other third countries may have more limited financial ties and interactions with the EU or may have a strong legal framework, leading to a more confined scope for global reach.

This section will systematically classify third countries into distinct groups based on their shared characteristics. By identifying these similarities, we aim to understand how such common features influence the EU's decision-making process regarding the equivalence or endorsement.

The concept of external economic differentiation, often discussed in the context of economic integration between the EU and third countries,[331] holds significant relevance for this research. In recent years due to phenomena like Brexit, this term has been used to refer to the level of integration of third countries. It contributes to the constitutional architecture of the EU.[332]

While traditionally employed in economic terms, we aim to analyze this division from a legal perspective to gain insights into the global reach that can be caused because of equivalence and endorsement. By delving into the legal dimensions of this concept, we can better understand how the

[331] Leruth, Gänzle and Trondal (n 244); Eisl (n 245).
[332] Fossum (n 235).

EU's engagement with third countries through EU law provisions such as endorsement and equivalence is affected by external economic differentiation, and how it shapes the landscape of financial services. This approach will provide a comprehensive view of the multifaceted relationship between the EU and third countries and shed light on the global reach of CRAs and CCPs’ framework.

This section will present a comprehensive classification of third countries based on various key factors. Initially, the division will be made between neighboring and non-neighboring countries of the EU. Further classification will then consider whether these neighboring and non-neighboring countries are EU candidates or not. The subsequent distinction will focus on non-neighboring countries, categorizing them into those with a substantial financial services' offering and those without. By analyzing and categorizing third countries in this manner, we will gain valuable insights into the factors influencing the EU's approach towards CCPs and CRAs from different regions. This research will demonstrate how external factors play a pivotal role in shaping the EU's regulatory decisions, ultimately enhancing our understanding of the dynamics between the EU and third countries in the realm of financial services regulation.

However, it is worth noting that such differentiation can also lead to fragmentation in the EU decision-making process concerning equivalence. It can be observed in other financial services where the differences between countries within the same group are minimal. For example, consider the equivalence decision for stock exchanges in Switzerland,[333]

[333] See more on the Swiss Case in footnote 323.

which had an expiry period of one year, whereas in the US, it was granted without any time limits.[334]

This discrepancy in decision-making can create complexities and inconsistencies, potentially affecting the overall efficiency and coherence of the EU's regulatory approach. As a consequence, it becomes crucial for the EU to strike a balance between accommodating the unique circumstances of different third countries and ensuring the stability and effectiveness of its financial regulatory framework.

The EU has different instruments to establish agreements concerning financial services with third countries. However, this section will evaluate some mechanisms that can determine the EU’s approach. The main formal arrangements providing third-country access to the EU Single Market are:
-The European Economic Area (EEA) agreement concluded with Norway, Iceland and Liechtenstein;
-The bilateral agreements governing the EU–Switzerland relationship;
-The EU Customs Union bilateral agreements concluded with Turkey and the micro-states Andorra and San Marino;
-The so-called deep and comprehensive free trade agreements (DCFTAs) signed with the Eastern European countries: Ukraine, Georgia and Moldova;
-The stabilization and association agreements (SAAs) with the Western Balkan states Serbia, Bosnia and Herzegovina, Albania, North Macedonia, Montenegro and Kosovo; and

[334] Commission Implementing Decision (EU) 2022/552 of 4 April 2022 determining that national securities exchanges of the United States of America that are registered with the Securities and Exchange Commission comply with legally binding requirements which are equivalent to the requirements laid down in Title III of Directive 2014/65/EU and are subject to effective supervision and enforcement, [2022] OJ L 107.

-The comprehensive free trade agreements (CFTAs) established with countries beyond the European continent such as Japan, South Korea and Canada.

It is essential to emphasize, as previously discussed in Chapter I, that this dissertation does not focus on trade agreements as a mechanism for determining the access of third-country CRAs or CCPs. Although these agreements may encompass financial services, it's crucial to note that CRAs and CCPs are still obligated to secure an equivalence decision or an endorsement, irrespective of the provisions within trade agreements.

Nevertheless, it is important to recognize that the various types of trade agreements can significantly influence the EU's decision-making process regarding equivalence or endorsement. This aspect contributes to the broader context of differentiated treatment among third countries, highlighting the nuanced approach taken based on the specific trade agreement in place.[335]

7.1 EU Neighboring Countries

The EU has a specific foreign policy addressed to its neighboring countries. This is the European Neighborhood Policy (ENP) and it was introduced by the EU during the big enlargement of 2004 in order to expand and strengthen its relationship with neighboring countries that would not be considered as candidates for membership (in a short term).[336] Originally conceived to encompass the enlarged EU's Eastern European neighbors, it was later extended to the Middle Eastern and North African partner

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[335] Shawn Donnelly, 'New Options for Differentiated Integration in the European Union: Introduction to the Special Section' (2022) 7 European Papers - A Journal on Law and Integration 1141.

[336] Roland Dannreuther, 'Developing the Alternative to Enlargement: The European Neighbourhood Policy' (2006) 11 European Foreign Affairs Review 183.

countries of the Euro-Mediterranean Partnership and to the Southern Caucasus.

Furthermore, accession requires possible members to adopt the entire acquis, and the old members to grant the new members equal rights and prerogatives.[337] The EU's acquis conditionality in the neighborhood has also suffered from weaknesses because the credibility of the market access incentive has been undermined by protectionist interest groups in the EU and the exclusion of some sectors such as agriculture.[338]

However, this case is different because the EU does not enjoy the same open negotiating power as in its relationship with candidates for membership. This is particularly true for the energy-exporting countries of the region.[339] Moreover, the EU competes with other powerful providers of external governance. This aspect is particularly important to this research because it can also happen with certain financial services and third countries that are significant suppliers of these services.

As a result, the EU has a chance to export its own rules to the neighborhood if the target countries are dependent on the EU or more dependent on the EU than on other countries or associations.[340] Otherwise, some authors have suggested that "self-conditionality"

[337] Marja-Liisa OEberg, *The Boundaries of the EU Internal Market: Participation without Membership* (Cambridge University Press 2020).
[338] Ulrich Sedelmeier, 'The European Neighbourhood Policy: A Comment on Theory and Policy' in Katja Weber, Michael E Smith and Michael Baun (eds), *Governing Europe's Neighbourhood: Partners or Periphery?* (Manchester University Press 2007).
[339] Schimmelfennig (n 254).
[340] Antoaneta Dimitrova and Rilka Dragneva, 'Constraining External Governance: Interdependence with Russia and the CIS as Limits to the EU's Rule Transfer in the Ukraine' (2009) 16 Journal of European Public Policy 853.

appears to work because countries that would like to become members behave as if they were subject to accession conditionality.[341]

7.1.1 Non-EU Candidates

The EU reached the European Economic Area (EEA) agreement with the countries of the European Free Trade Association.[342] In this agreement, the EEA countries (Iceland, Norway, and Liechtenstein) are officially required to implement all EU legislation regarding the Single Market and several related policy fields as well as the case law of the ECJ.[343] The EEA countries also participate in the informal preparation of EU legislation that concerns them ("decision-shaping"), but they do not take part in the formal decision-making process.[344] Nevertheless, for some authors EEA countries comply extremely well with their legal obligations and for this reason, they can be considered as "quasi-members" that are subject to the core of EU rules in almost the same way as the member states.[345]

This interaction results from a combination of high economic interdependence with the EU and strong popular opposition to full membership.[346] In Norway and Switzerland, formal EU accession was blocked by negative popular referendums and required these countries to manage their intense market and policy relationships with the EU below the level of full supranational integration.[347] The basic mechanism behind

[341] Amy Verdun and Gabriela E. Chira, 'From Neighbourhood to Membership: Moldova's Persuasion Strategy towards the EU' (2008) 8 Southeast European and Black Sea Studies 431.
[342] Rennuy and Van Elsuwege (n 244).
[343] Directorate-General for Internal Policies (European Parliament) and others, 'Review of EU-Third Country Cooperation on Policies Falling within the ITRE Domain in Relation to Brexit' (2017).
[344] Rennuy and Van Elsuwege (n 244).
[345] Schimmelfennig (n 254); Sandra Lavenex, Dirk Lehmkuhl and Nicole Wichmann, 'Modes of External Governance: A Cross-National and Cross-Sectoral Comparison' (2009) 16 Journal of European Public Policy 813; Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53).
[346] Schimmelfennig, Leuffen and Rittberger (n 244).
[347] Van Elsuwege (n 242).

this interaction is a highly institutionalized form of conditionality. Through this mechanism the EU grants equal market access in return for the rules' adoption.

Conversely, decisions pertaining to third-country Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) within the EU have acquired heightened significance in the wake of Brexit. This heightened relevance stems from the critical role British financial services play for both the United Kingdom and the European Union.

Since 2021, a pivotal shift has occurred for CCPs and CRAs operating between the UK and the EU. The cessation of passporting between these entities and the EU took effect on 31 December 2020, necessitating the application of endorsement or equivalence decisions for market access in both directions.[348] The significance of this transition is further accentuated by the fact that the Trade and Cooperation Agreement (TCA) reached between the UK and the EU scarcely addressed financial services. Although a significant development transpired on 27 June 2023 with the long-anticipated signing of a Memorandum of Understanding (MoU) aimed at establishing a framework for financial services regulation, notably absent from this document was any explicit reference to equivalence, endorsement, or other relevant instruments for the designated services.[349] Consequently, the burden for CCPs and CRAs remains unchanged, with the requirement to seek equivalence or endorsement to access the EU market.

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[348] British government, 'Financial Services and the EU (Banking and Regulation)' (*Brexit*, 2021)<https://assets.publishing.service.gov.uk/media/5a7dc48ee5274a5eb14e7108/Financial_services_and_banking_summary.pdf> accessed 28 November 2023.

[349] Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland (27 June 2023).

According to certain authors, the concept of equivalence assumes a dual role, potentially serving as a strategic and political instrument, especially with regard to the relocation of clearing services previously centered in the UK to within the EU.[350] This dynamic permeates the equivalence decision with broader significance, extending beyond the realm of technical compatibility. Additionally, a worrisome factor arises from the significant number of firms that have shifted operations from the UK to various EU member states, raising concerns about potential conflicts of interest for the EU. This situation emphasizes the complexity and multifaceted nature of the equivalence framework, as it intersects with political, economic, and regulatory considerations, necessitating careful evaluation. This analysis will be further developed as a case study in Chapter VII.

7.1.2 EU Candidates

The EU's relations with the candidate countries for membership are another case of interaction between the EU and third countries. In these cases, before starting the negotiations with third countries, the EU focuses on the general principles of European governance, in particular, Article 49 of the TEU, as one of the main principles of eligibility for membership.

During the accession negotiations, the focus is on the issue-specific rules of European governance. The purpose of accession is the applicants' adoption of the entire body of EU legislation and policies codified in the acquis communautaire.[351] The negotiations concern the possibility and

[350] Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).
[351] Marja-Liisa Öberg, 'Internal Market Acquis as a Tool in EU External Relations: From Integration to Disintegration' (2020) 47 Legal Issues of Economic Integration 151.

length of “transition periods” during which the application of EU rules is suspended after accession.[352]

The interaction with candidate countries relies predominantly on conditionality as well. The EU's main activities in these cases consist in setting conditions for membership, monitoring candidates’ progress in compliance, and granting or withholding the reward accordingly.[353] Membership is the highest reward the EU can offer to third countries. It gives them full and equal access to the internal market, the funds, the decision-making institutions, and the legal remedies of the most important economic and political organization of the continent. In addition, the credibility of conditionality is generally high as well.

Usually, EU candidates can expect to be admitted after fulfilling the requirements to be accepted because the EU has been consistent in applying its conditions. However, there are a few exceptions, for instance, Cyprus and Turkey. In the case of the Central and Eastern European countries, their adoption of EU rules was careful and sparse during the early part of the transition period and followed domestic traditions or the rules of other international organizations.[354] These countries’ rules converge towards EU law because they have been offered a credible membership perspective.[355]

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[352] Támas Molnár, *The Interplay between the EU’s Return Acquis and International Law* (Edward Elgar Publishing Inc 2021).
[353] Bruno De Witte and Anne Thies, ‘Why Choose Europe? The Place of the European Union in the Architecture of International Legal Cooperation’ in Bart Van Vooren, Steven Blockmans and Jan Wouters (eds), *The EU’s Role in Global Governance* (Oxford University Press 2013).
[354] Frank Schimmelfennig and Ulrich Sedelmeier, ‘Introduction: Conceptualising the Europeanization of Central and Eastern Europe’, *The Europeanization of Central and Eastern Europe* (Cornell University Press 2005).
[355] Frank Schimmelfennig and Ulrich Sedelmeier, ‘Conclusions: The Impact of the EU on the Accession Countries’ in Frank Schimmelfennig and Ulrich Sedelmeier (eds), *The Europeanization of Central and Eastern Europe* (Cornell University Press 2005).

In this context, the European Union possesses the strategic leverage to employ internal market access as a tool for conditionality.[356] This approach involves using conditions to drive policy adjustments or to compel the adoption of policies that a third country might not have otherwise implemented.[357] A notable illustration of this is the Deep and Comprehensive Free Trade Area (DCFTA), a component of the Association Agreement (AA) established between the EU and Ukraine in 2014, specifically founded on the principle of market access conditionality.[358] This concept is pivotal in comprehending the extensive impact of EU law, as it sometimes operates based on conditionality rather than territorial extension provisions. It's worth noting that market access conditionality was firmly established as a legally binding mechanism within the DCFTA between the EU and Ukraine,[359] which implies that this unique form of conditionality may not apply uniformly to other third countries.

7.2 Countries Distant From the EU

The EU has trading partners around the world. Hence, references to international standards in financial services are not limited to specific agreements with neighboring countries. For example, the EU's Free Trade Agreement with South Korea contains a provision on financial governance, committing the parties to the implementation of "internationally agreed standards for regulation and supervision in the financial services

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[356] I. Borchert *et al*., 'The Pursuit of Non-Trade Policy Objectives in EU Trade Policy', 1 *World Trade Review* 2021 9.

[357] O. Morrissey, 'Alternatives to Conditionality in Policy-Based Lending', in S. Koeberle *et al.* (eds.), *Conditionality Revisited: Concepts, Experiences, and Lessons Learned* (Washington DC: World Bank 2005), 237.

[358] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part (signed on 27 June 2014) [2014] OJ L 161/3, 29.05.2014; G. Van der Loo, *The DCFTA: Market Access Conditionality and Mechanisms to Ensure the Uniform Interpretation and Application of the EU Acquis* (Leiden: Brill/Nijhoff 2016), 210.

[359] Ibid, 208.

sector".[360] However, countries with these provisions such as South Korea and Canada must still apply for equivalence and endorsement to access the EU single market.

Moreover, rules that have global reach usually concern issue-specific matters relating to its internal market. Hence, different consequences in third countries converge on the finding that EU impact is a function of the size of the EU market, its relevance for third countries, and the strength of EU regulation.[361] However, the EU fosters its rules as part of a predominant strategy of regulatory alignment and common policies.[362] Nevertheless, depending on the distance between the EU and the third country, mechanisms of externalization of EU law are much less in evidence. In this regard, financial services have a significant role because externalization of EU rules through economic interdependence can occur. Furthermore, governance by externalization is characteristic of the export of EU law through its relations with democratic, market-oriented, and highly industrialized OECD countries.[363] The greater OECD region is not as dependent on the single market as EU neighboring countries.[364] Therefore, the reach of EU law is different. However, the EU deals with some OECD countries either bilaterally or in the context of global organizations such as the UN or the WTO.[365] Moreover, the size of the

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[360] Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part, (signed on 15 October 2009) [2011] OJ L 127/6, 14.05.2011.
[361] David Bach and Abraham L Newman, 'The European Regulatory State and Global Public Policy: Micro-Institutions, Macro-Influence' (2007) 14 Journal of European Public Policy 827; Sebastiaan Princen, 'Exporting Regulatory Standards: The Cases of Trapping and Data Protection' in Sebastiaan Princen and Michele Knodt (eds), *Understanding the European Union's external relations* (Routledge 2003).
[362] Schimmelfennig (n 254).
[363] ibid.
[364] Peter Berkowitz, Ángel Rubianes Catalina and Pieńkowski Jerzy, 'The European Union's Experiences with Policy Conditionalities' (2018); Cremona and Leino-Sandberg (n 291).
[365] Schimmelfennig (n 254).

financial markets of these third countries determines whether to establish an agreement or to determine the EU's approach.[366]

7.2.1 Third Countries with Higher Impact on the EU's Single Market

This classification encompasses countries situated considerably far from the EU's borders, maintaining significant trade ties with the EU, yet not exhibiting the same level of interdependency as seen with Switzerland or the UK.[367] The United States (US) serves as a prime illustration within this category. The US boasts an advanced financial market, and its position as a fully developed and independent third country plays a pivotal role in shaping the global reach of EU law within its jurisdiction.[368] For instance, transatlantic cooperation on financial markets regulatory cooperation only truly emerged in the 1990s, continuing into the 2000s, as the EU's single market program drove financial markets regulatory harmonization within the EU. The result was a progressively developing body of distinctly "European" financial markets rules and standards that rivaled the US in the international market. It was a body of rules that intensified market access and operational concerns in the US.[369]

This holds particular significance, as the US is unlikely to undergo substantial modifications to its financial services legislation. Remarkably, the US has, in fact, exported its regulatory frameworks, and its influence

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[366] Pennesi, 'Equivalence in the Area of Financial Services: An Effective Instrument to Protect Eu Financial Stability in Global Capital Markets?' (n 313).
[367] R. Schwok, 'Switzerland-EU Relations: The Bilateral Way in a Fragilized Position', 25 *European Foreign Affairs Review* 2020, 159–176, at 160.
[368] F. Pennesi, 'Equivalence in the Area of Financial Services: an Effective Instrument to Protect EU Financial Stability in Global Capital Markets?', 58 *Common Market Law Review* 2021, 39–70, at 54.
[369] Peter O'Shea, 'Introduction and Framework' in Peter O'Shea (ed), *Transatlantic Financial Regulation US-EU Cooperation During the 2008 Financial Crisis* (Springer 2021).

is acknowledged in the global application of its financial laws.[370] Nevertheless, it did modify once its regulation concerning financial conglomerates in order to be equivalent to the EU standards which clearly demonstrate the power of EU equivalence.[371]

For these reasons, it is essential to note that the US case is unique due to some equivalence decisions between the EU and the US in the realm of Credit Rating Agencies being granted without an explicit time limit.[372] This adds a distinctive dimension to the EU's engagement with the US, warranting further scrutiny and analysis.

7.2.2 Third Countries with Lower Impact in the EU's Single Market

There is a third category concerning third countries with financial markets that have a lower impact on the EU. For instance, in Singapore, CRA equivalence was withdrawn as they failed to modify their internal legislation. For a concrete example, the Monetary Authority of Singapore (MAS) has stated that it is working on keeping its financial legislation 'at the European level'.[373] In this regard, Pennesi and Okonjo have previously

[370] A. Laby, 'The Extraterritorial Application of U.S. Financial Services Regulation', 2 *Swiss Review of Business Law* 2017.

[371] Dür (n 243).

[372] Commission Implementing Decision (EU) 2019/1279 of 29 July 2019 on the recognition of the legal and supervisory framework of the United States of America as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies C/2019/5803, *OJ* [2019] L 201/26, 30.7.2019; R. Horzempa, 'MiFID II and the Importance of Equivalence Decisions', 37 Review of Banking and Financial Law 2018, at 604.

[373] Monetary Authority of Singapore (MAS), '"The Future of Finance is Green" - Transcript of Fireside Chat with Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, and Mr Mark Carney, Secretary-General's Special Envoy for Climate Action and Finance, United Nations, moderated by Dr James Crabtree, Associate Professor in Practice, Lee Kuan Yew School of Public Policy, National University of Singapore at the Singapore FinTech Festival on 9 December 2020', Speeches (9 December 2020), <https://www.mas.gov.sg/news/speeches/2020/the-future-of-finance-is-green> accessed 28 November 2023; Monetary Authority of Singapore (MAS), 'Reply to Parliamentary Question on the European Commission's decision to repeal the equivalence status for Singapore credit rating agencies', Parliamentary replies for parliament sitting (2 September 2019), available at:

highlighted the fact that the global reach of EU law can have a different impact depending on the size, relevance and location of the third country's financial markets.[374]

Of particular note, unlike the situation with US CRAs, Australia faced a revocation of its equivalence decision due to its failure to update its legislation to align with EU standards following a crucial amendment implemented by the EU (CRA Regulation II). This specific case will be thoroughly examined as a comprehensive case study in Chapter VII.

On the other hand, the indirect mechanism of imitation works with these third countries. The EU has not directly encouraged or induced the establishment of major regional organizations such as the Andean Community and Mercosur in Latin America, ASEAN in Southeast Asia, or the African Union.[375] However, these countries have emulated EU institutions and policies.

8 Conclusion

In conclusion, the exploration of extraterritoriality and territorial extension as forms of global reach in the field of CRAs and CCPs exposes a relatively unknown terrain within the EU regulatory landscape. The brussels effect, a direct outcome of this global reach facilitated by the endorsement and equivalence provisions, showcases the far-reaching influence of EU law beyond its borders, fundamentally shaping third countries' legislation and global financial standards. The EU's influence,

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<https://www.mas.gov.sg/news/parliamentary-replies/2019/reply-to-parliamentary-question-on-the-european-commissions-decision-to-repeal> accessed 28 November 2023.

[374] See F. Pennesi (n 117); J. Okonjo, 'Assessing the Impact of the Extraterritorial Provisions of the European Markets Infrastructure Regulation (EMIR) on Emerging Economies' OTC Derivatives Markets: A Doctrine of Proportionality Perspective Challenges and Unresolved Issues', 7 *The Indian Journal of International Economic Law* 2015, at 8.

[375] Schimmelfennig, Leuffen and Rittberger (n 244).

as evident through the power of its single market, is intricately interlinked to its external relations, offering a platform for applying this regulatory authority. Furthermore, the EU is confronted with a pivotal dilemma in striking a balance between safeguarding its domestic interests, opening up the single market, and prioritizing financial stability. The significance of the latter, given the potential risks, highlights its importance as a paramount consideration. Additionally, the global reach of EU law demonstrates differentiation, depending on the third country in question, highlighting varying impacts and complexities that need to be addressed.

PART II: LEGAL FRAMEWORK

CHAPTER IV: ANALYSIS OF THE INTERNATIONAL LEGAL FRAMEWORK OF THE SELECTED FINANCIAL SERVICES

This chapter serves as a comprehensive analysis of the international framework governing CRAs and CCPs, shedding light on the challenges posed by their regulation and the subsequent impact on the EU's regulatory framework of these services. To accomplish this, the chapter will delve into the dynamic initiatives and critical issues shaping the global regulatory landscape for CRAs and CCPs, identifying key institutions and their roles in this process. Subsequently, the spotlight will be on the European Union's financial regulation, analyzing pivotal events that have molded its evolution and exploring the diverse regulatory approaches used. Hence, the objective of this chapter is to provide a comprehensive overview of the international benchmarks that serve as the foundation for regulatory measures in the EU.

1 Literature Review

After the global financial crisis of 2008, the role of CRAs and CCPs as essential financial services came under intense scrutiny from international fora. In response to the crisis, various global organizations, such as the Group of 20 (G20),[376] International Organization of Securities

[376] Group of 20 (G20), 'Declaration on Strengthening the Financial System-London Summit' (2009); Stephen Pickford, 'The G20 and Financial Sector Reforms' in Mike Callaghan and others (eds), *Financial regulation and the G20* (2013); Eric Helleiner and Stefano Pagliari, 'The G20 Leaders' Summit and the Regulation of Global Finance: What Was Accomplished?' (2008) 11; Group of 20 (G20), 'Communiqué of the Meeting of the G20 Finance Ministers and Central Bank Governors. Sao Paulo Summit' (2008).Ross P Buckley, 'The G20's Performance in Global Financial Regulation' (2014) 37 University of New South Wales Law Journal 63.

Commissions (IOSCO),[377] International Monetary Fund (IMF),[378] the Financial Stability Board (FSB),[379] and the Committee on Payments and Market Infrastructures (CPMI),[380] among others, published numerous reports expressing their apprehension about the risks associated with CRAs and CCPs. These reports highlighted the need for enhanced regulation and supervision to address potential vulnerabilities and safeguard financial stability.

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[377] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies (March 2015) FR05/2015' (n 5); Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS) (n 102); Board of the International Organization of Securities Commissions (IOSCO), 'Supervisory Colleges for Credit Rating Agencies. Final Report' (2013); Board of the International Organization of Securities Commissions (IOSCO) and Committee on Payments and Market Infrastructures (CPMI) (n 44); Committee on Payment and Settlement Systems (CPSS) and Board of the International Organization of Securities Commissions (IOSCO), 'Principles for Financial Market Infrastructures: Disclosure Framework and Assessment Methodology' (2012).

[378] Financial Stability Forum (FSF) currently Financial Stability Board (FSB), 'Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience' (2008) 1 <https://www.fsb.org/wp-content/uploads/r_0804.pdf?page_moved=1> accessed 28 November 2023; Financial Stability Board (FSB), International Monetary Fund (IMF) and Bank for International Settlements (BIS), 'Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations. Report to the G-20 Finance Ministers and Central Bank Governors' (2009).

[379] Financial Stability Board (FSB), 'Guidance on Central Counterparty Resolution and Resolution Planning' (2017); Financial Stability Board, 'Principles for Reducing Reliance on CRA Ratings' (2010); Financial Stability Forum (FSF) currently Financial Stability Board (FSB), 'Report on Enhancing Market and Institutional Resilience' (2008); Financial Stability Board (FSB) and others, '2015 CCP Workplan' (2015); Financial Stability Board (FSB), International Monetary Fund (IMF) and Bank for International Settlements (BIS) (n 3); Financial Stability Board (FSB), 'Improving Financial Regulation: Report of the Financial Stability Board to G20 Leaders' (2009); Financial Stability Board (FSB), 'Overview of Progress in Implementing the London Summit Recommendations for Strengthening Financial Stability: Report of the Financial Stability Board to G20 Leaders' (2009); Matthias Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (2019).

[380] Committee on Payment and Settlement Systems (n 147); Committee on Payments and Market Infrastructures (CPMI) and International Organization of Securities Commissions (IOSCO), 'Recovery of Financial Market Infrastructures' (2017).

The crisis exposed the limitations and potential conflicts of interest within CRAs, leading to calls for enhanced regulation and oversight.[381] The EU institutions took significant steps to enhance and strengthen the regulation of CRAs.[382] This led to the introduction of the Credit Rating Agencies Regulation (CRA Regulation I) in 2009. Additionally, the European Securities and Markets Authority (ESMA) was designated as the central authority responsible for supervising CRAs in the EU.[383] The perspectives of Deipenbrock, Moloney and Partnoy underscore the complex nature of implementing international standards for regulating

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[381] Committee on the Global Financial System, 'Ratings in Structured Finance: What Went Wrong and What Can Be Done to Address Shortcomings?' (2008) 32; Technical Comittee of International Organization of Securities Commissions (IOSCO) (n 49); Sy (n 71); European Securities and Markets Authorities (ESMA) (n 14).

[382] Committee of European Securities Regulators (CESR), 'CESR's Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and the Role of Credit Rating Agencies in Structured Finance (May 2008) CESR/08-277' (n 49); Committee of European Securities Regulators (CESR), 'Technical Advice to the European Commission on Possible Measures Concerning Credit Rating Agencies (CESR/05-139b)'; Committee of European Securities Regulators (CESR), Report on compliance of EU-based credit rating agencies with the 2008 IOSCO Code of Conduct (Ref. CESR/09-417) 2008; European Commission, Consultation document on a proposal for a Directive/Regulation of the European Parliament and of the Council on Credit Rating Agencies 2008; Committee of European Securities Regulators (CESR), Report on compliance of EU-based credit rating agencies with the 2008 IOSCO Code of Conduct (Ref. CESR/09-417) 2009; European Commission, 'Commission Staff Working Document Paper. Impact Assessment Accompanying the Document Proposal for a Regulation Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies and a Proposal for a Directive Amending Directive 2009/65/EC on coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers' (2011); European Parliament (n 100).

[383] European Securities and Markets Authority (ESMA), 'Opinion of the European Securities and Markets Authority of 22 September 2021 on Improving Access to and Use of Credit Ratings in the European Union in Accordance with Regulation (EC) No 1060/2009' (2021) 30 September 2021 ESMA80-196-5819; European Securities and Markets Authority (ESMA), 'Final Report. Update of the Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation' (2017); European Securities and Markets Authority (ESMA), 'Final Report. Technical Advice on CRA Regulatory Equivalence – CRA 3 Update' (2017); European Securities and Markets Authority (ESMA), 'Guidelines on the Scope of the CRA Regulation' (2022).

CRAs in the EU.[384] Their viewpoints highlight the importance of finding a harmonious balance between multiple objectives. On one hand, ensuring financial stability and investor protection is crucial for safeguarding the integrity of the financial system and maintaining confidence in the market. On the other hand, preserving market efficiency and allowing for some flexibility in regulatory approaches is essential to accommodate the diverse characteristics and circumstances of the EU.

Similarly, the role of CCPs as crucial financial intermediaries became evident during the financial crisis, but contrary to CRAs, it was especially because of their ability to mitigate counterparty risk in derivative transactions.[385] In the aftermath of the financial crisis, EU institutions responded proactively to strengthen the regulatory framework and oversight of CCPs as well. The introduction of the European Market Infrastructure Regulation (EMIR) in 2012 marked a significant milestone in the EU's efforts to address the risks posed by CCPs in the financial system. EMIR brought about a comprehensive set of rules aimed at enhancing transparency, risk management, and supervision of CCP activities that ESMA has developed through guidelines and opinions.[386] In particular, ESMA helped to introduce IOSCO's standards by developing the *Guidelines and Recommendations Regarding the Implementation of the CPSS-IOSCO Principles for Financial Market Infrastructures in Respect*

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[384] Mads Andenas and Gudula Deipenbrock, 'Credit Rating Agencies and European Financial Market Supervision' (2011) 16; Moloney, 'Gatekeeper Regulation and the EU' (n 68); Partnoy (n 49).

[385] Balmer (n 104). Lucia Quaglia, 'International Standards for CCPs', *The Politics of Regime Complexity in International Derivatives Regulation* (2020). Daniela Russo, 'CPSS-IOSCO Principles for Financial Market Infrastructures: Vectors of International Convergence' (2013).

[386] European Securities and Markets Authority (ESMA), 'Final Report Guidelines on the Application of the Endorsement Regime under Article 4 (3) of the Credit Rating Agencies Regulation No 1060/2009 18 May 2011, ESMA/2011/139'; European Securities and Markets Authority (ESMA), 'Guidelines on CCP Conflict of Interest Management: ESMA' (2019).

of Central Counterparties.[387] Nevertheless, the role of the ESMA in the regulation and supervision of CCPs has been criticized by scholars such as Bianco and Canini, with concerns raised about potential concentration of power in a single institution.[388] This concentration of authority can pose certain risks and challenges that need careful consideration. Therefore, a well-coordinated approach is vital to ensure effective oversight while avoiding undue concentration of power in one institution.

2 Global Challenges in Regulating Financial Services: CRAs and CCPs

When it comes to international standards and cross-border elements, both CRAs and CCPs face certain common challenges in their regulation. These challenges stem from the need to ensure consistency and harmonization across different jurisdictions, as well as to address the complexities that arise when these services operate across national borders. The regulatory frameworks for CRAs and CCPs must effectively navigate these common issues to establish robust international standards that promote transparency, stability, and the fair functioning of financial markets.

A persistent and perplexing problem lies in the fact that regulatory standard setting is not directly aligned with the practical challenges of international trade, as trade and regulatory fora operate with distinct objectives and often lack collaboration.[389]

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[387] European Securities and Markets Authority (ESMA), 'Guidelines and Recommendations Regarding the Implementation of the CPSS-IOSCO Principles for Financial Market Infrastructures in Respect of Central Counterparties' (2014).

[388] Giuseppe Bianco, 'Strengths and Weaknesses of the ESMA-SEC Supervisory Cooperation' in Mads Andenas and Gudula Deipenbrock (eds), *Regulating and Supervising European Financial Markets* (Springer 2016); Canini (n 107).

[389] Christoph Ohler, 'CETA, TTIP, TiSA, and Financial Services' in Stefan Griller, Walter Obwexer and Erich Vranes (eds), *Mega-Regional Trade Agreements: CETA, TTIP, and TiSA: New Orientations for EU External Economic Relations* (Oxford University Press

Another significant issue is the lack of binding obligations for participants in international fora regarding agreed-upon international standards.[390] While soft law plays a crucial role in international financial law, the voluntary nature of adopting international standards into domestic law makes achieving harmonization a challenging task.[391] The absence of mandatory implementation poses obstacles to achieving a consistent and coordinated approach across countries.

On the other hand, the widespread use of rules with extraterritorial effect by jurisdictions such as the EU and the USA exemplified by provisions such as some articles of the Regulation (EU) 648/2012 on OTC derivatives, central counterparties, and trade repositories can produce unintended consequences for financial services providers.[392] These entities may find themselves subjected to numerous prudential requirements that must be met in accordance with the legal frameworks of multiple countries.[393] The fundamental challenge in such cases lies in the lack of harmonization between these requirements, as each country may impose distinct conditions.[394] This creates significant barriers for the cross-border operation of the financial services industry. Moreover, countries are actively encouraging companies to establish themselves

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2017); Samuel McPhilemy, 'Integrating Rules, Disintegrating Markets: The End of National Discretion in European Banking?' (2014) 21 Journal of European Public Policy 1473.

[390] Abraham L Newman and Elliot Posner, 'Disruptive Soft Law and Post-Crisis US Reform', *Voluntary Disruptions: International Soft Law, Finance, and Power* (Online, Oxford University Press 2018).

[391] Ohler (n 389).

[392] European Parliament and European Council, Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories Regulation 648/2012, *OJ* [2012] L 201/1, 27.07.2012.

[393] Ohler (n 389).

[394] Christian Tietje and Matthias Lehmann, 'The Role and Prospects of International Law in Financial Regulation and Supervision' (2010) 13 Journal of International Economic Law 663.

within their own jurisdictions, aiming to separate them from multinational groups.[395]

3 Global Efforts in Regulating Financial Services: Implementing Worldwide Initiatives in the EU

International regulatory fora play a crucial role in establishing a legal framework for financial services; however, the lack of binding force is one of the significant challenges in this domain.[396] The absence of enforceability mechanisms poses a considerable obstacle to ensuring compliance with these rules. Nonetheless, despite their nonbinding nature, these rules have played a vital role in harmonizing and standardizing financial services. [397] The use of soft law in this context is driven by various reasons, each serving a specific purpose in the regulatory landscape.

The EU's position in international regulatory fora can be weakened as a result of internal disputes among Member States and institutions.[398] This can have implications for the EU's ability to assert its interests and influence the rules that are established in these fora. As a result, the EU may find itself in a less certain position when it comes to the rules and regulations created in these international forums.[399] In order to gain a deeper understanding of the EU's position in international institutions that play a pivotal role in shaping standards with potential impact on the EU's approach to regulate the selected financial services, this section will

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[395] Ruth V. Aguilera and Rafel Crespi-Cladera, 'Global Corporate Governance: On the Relevance of Firms' Ownership Structure' (2016) 51 Journal of World Business 50.
[396] Roberta S Karmel and Claire R Kelly, 'The Hardening of Soft Law in Securities Regulation' (2009) 34 Brooklyn Journal of International Law 884.
[397] Marc I Steinberg, Franklin A Gevurtz and Eric Chaffee, *Global Issues in Securities Law* (West Academic Publishing 2013).
[398] Kuner (n 246).
[399] ibid.

examine key international institutions that exert substantial influence over the EU's financial regulation. Specifically, this research examines the crucial roles played by five organizations in the regulation and oversight of CRAs and CCPs, which have a substantial presence in the EU market. By closely examining the G20, the IOSCO, the Financial Stability Board (FSB), and the CPMI, this study aims to shed light on the intricate dynamics and regulatory frameworks that shape the EU's engagement with these key stakeholders in the global financial landscape.

Various monitoring systems have been established worldwide to regulate CRAs in response to the subprime crisis that commenced in 2007. These systems aim to address specific concerns associated with this industry and can be categorized into the following approaches.[400]

One approach to regulating CRAs involves treating them as direct subjects of legislation and implementing a comprehensive regulatory system that applies to all agencies.[401] Under this approach, any entity that meets the criteria specified in the legislation would be required to adhere to the regulatory requirements, regardless of how market participants utilize its ratings. This is the alternative followed by the EU regulation for EU CRAs.

The second approach views CRAs as indirectly affected by the legislation and focuses on regulating how ratings are utilized by market participants. Under this system, the agencies are indirectly regulated as they must meet the legislative requirements for their ratings to be utilized by market participants.[402] This approach mirrors the one adopted by the US

[400] Daniel Cash, *Regulation and the Credit Rating Agencies Restraining Ancillary Services* (Routledge 2019).
[401] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).
[402] Patrick Bolton, Xavier Freixas and Joel Shapiro, 'The Credit Rating Game' (2012) 67 The Journal of Finance 85.

legislature, where CRAs are not mandated to register solely based on issuing credit ratings. Instead, they can opt to become NRSROs (Nationally Recognized Statistical Rating Organizations) to enable the use of their ratings for regulatory purposes.[403]

4 Institutions Leading Regulatory Proposals for Selected Financial Services

Contrary to CCPs, CRAs exhibited poor performance both before and during the financial crisis.[404] Consequently, international initiatives aimed at rectifying past mistakes and enhancing their functioning for the future. The responsibility for establishing standards and improving existing guidelines in this regard fell upon international bodies such as the G-20, the Financial Stability Board (FSB), and the International Organization of Securities Commissions (IOSCO).[405] These entities worked diligently to address the shortcomings and vulnerabilities identified within the CRA industry, seeking to strengthen oversight and regulation to prevent similar crises from occurring in the future.[406]

This is because the market failures identified were not promptly addressed due to the absence of direct supervision and enforcement in many countries and the inadequate powers conferred upon authorities in jurisdictions where some form of supervision existed.[407] As evidenced by

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[403] Herwig Langohr and Patricia T Langohr, *The Rating Agencies And Their Credit Ratings: What They Are, How They Work, And Why They Are Relevant* (John Wiley & Sons 2010).
[404] Stefano Pagliari, 'Who Governs Finance? The Shifting Public-Private Divide in the Regulation of Derivatives, Rating Agencies and Hedge Funds' (2012) 18 European Law Journal 44, p. 55.
[405] Claudio Borio, Marc Farag and Nikola Tarashev, 'Post-Crisis International Financial Regulatory Reforms: A Primer (April 2020)' 859 BIS Working Papers.
[406] ibid.
[407] Donato Masciandaro and Marc Quintyn, 'Regulating the Regulators: The Changing Face of Financial Supervision Architectures Before and After the Financial Crisis' in Donato Masciandaro and Sylvester Eijffinger (eds), *Handbook of Central Banking, Financial Regulation and Supervision* (Edward Elgar Publishing 2011).

the numerous global and national initiatives, the self-regulatory system was deemed insufficient to ensure the proper performance of CRAs.[408]

Consequently, in some jurisdictions such as the United States, public authorities, market participants, and academics recognized the necessity to enhance the legislative and supervisory frameworks governing CRAs.[409] However, most international financial centers, including the EU, lacked a system of public oversight and regulation for CRAs at that time.[410] Hence, they had to assess the need for implementing such a regulatory regime later.

On the other hand, the international bodies responsible for setting standards for CCPs are the Committee on Payments and Market Infrastructures (CPMI), formerly known as the Committee on Payment and Settlement Systems (CPSS), the IOSCO and the Financial Stability Board. These institutions released in 2012 the Principles for Financial Market Infrastructures (PFMI), which built upon the previously published Recommendations for Central Counterparties in 2004.[411] These publications establish a global framework of standards that CCPs and their regulators should adhere to. In 2017, CPMI-IOSCO provided more detailed guidance on the resilience of central counterparties through the publication of "Further guidance on the PFMI".[412]

[408] Altman and others (n 49).
[409] Darbellay and Partnoy (n 50).
[410] Hiss and Nagel (n 51).
[411] Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS) (n 102); Committee on Payment and Settlement Systems (CPSS) and Technical Comittee of International Organization of Securities Commissions (IOSCO) (n 124).
[412] Bank for International Settlements (BIS), Committee on Markets and Financial Infrastructures (COMFI) and Board of the International Organization of Securities Commissions IOSCO, 'Further Guidance on the PFMI' (2017) 163.

4.1 The Role of the Group of 20 (G-20)

This organization works with experts on the regulation and supervision of financial services and creates technical guidelines to be applied globally.[413] However, this work falls short of effectiveness for different reasons.[414] One of these is that trade in financial services evolves much faster and becomes more complex with time, and the other aspect is the high level of technicality.[415]

Some authors have argued that the G20's effort is not sufficient because there is another issue with setting international guidelines on financial services: countries have problems trusting each other because they have discrepancies in their approaches to regulation and their domestic interests.[416] In the aftermath of financial crises, countries worldwide are inclined to protect their domestic financial systems from both external and internal risks, which in turn influences their regulatory strategies.[417]

4.1.1 CRAs

CRAs have been included in the regulatory agenda of governments and institutions worldwide through the efforts of the G-20.[418] During the São Paulo meeting in November 2008, the G-20 Finance Ministers and Central Bank Governors made a significant mention of CRAs in their final statement. For the first time, CRAs were specifically recognized as

[413] Tamilla Nurizada, 'A Global Body and a Global Problem: The Curious Case of the G-20 and Securities Regulation' (2017) 50 Cornell International Law Journal 643.
[414] Pickford (n 376).
[415] Ohler (n 389).
[416] See ibid; Daniel K Tarullo, *Banking on Basel: The Future of International Financial Regulation* (Federal Reserve Board 2008).
[417] Ohler (n 6), 199.
[418] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).

"systemically important institutions" that required proper oversight.[419] Shortly after, during the Washington summit, G-20 leaders emphasized the need for immediate action regarding CRAs and outlined action points to be implemented by 31 March 2009.[420] These actions were aimed at addressing the regulatory challenges associated with CRAs and ensuring enhanced oversight of their operations. Furthermore, in the same communiqué, the G-20 also included a medium-term action plan regarding CRAs, stating that CRAs involved in providing public ratings should undergo a registration process.[421] This agreement was further developed in the G-20 leaders' communiqué April 2009.[422]

Since the April 2009 statement, the G-20 has consistently emphasized in its subsequent communiqués the importance of enhancing the resilience of the financial system through regulatory oversight of CRAs.[423] Moreover, the G-20 has emphasized the importance of CRAs improving transparency, elevating the quality of their ratings, mitigating conflicts of interest, and has urged national supervisors to prioritize these areas in their supervisory efforts.[424]

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[419] Group of 20 (G20), 'Communiqué of the Meeting of the G20 Finance Ministers and Central Bank Governors. Sao Paulo Summit' (2008), <http://www.g20.utoronto.ca/2008/2008communique1109.html> accessed 28 November 2023.
[420] Group of 20 (G20), 'Declaration of the Summit on Financial Markets and the World Economy-Washington Summit' (2008) <https://georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081115-1.html#:~:text=We%2C the Leaders of the,in the world's financial systems> accessed 28 November 2023.
[421] Helleiner and Pagliari (n 376).
[422] Group of 20 (G20), 'Declaration on Strengthening the Financial System-London Summit' (n 376).
[423] Buckley (n 376).
[424] ibid.

4.1.2 CCPs

The G-20 has played a crucial role in developing comprehensive guidelines for CCPs, highlighting their importance in promoting financial stability and resilience. This is because the transition to central clearing is a crucial aspect of financial system reforms following the global financial crisis.[425] In order to mitigate systemic risks associated with bilateral trading, the G20 Leaders agreed in 2009 that standardized derivatives contracts should be traded on exchanges or electronic platforms and cleared through CCPs.[426] CCPs demonstrated their resilience during the crisis by continuing to clear contracts when bilateral markets became inactive.[427]

Since then, central clearing has undergone significant changes. The proportion of centrally cleared transactions has grown substantially, CCPs have expanded, and the industry remains concentrated.[428] Additionally, a broader range of banks and financial institutions now rely on CCPs for their transactions.[429] As a result, CCPs have become increasingly interconnected within the global financial system. This interconnectedness raises concerns about the potential spread of losses in the event of defaults and the impact on systemic stress through deleveraging pressures.[430]

Global standard setters have made significant efforts to enhance the resilience of individual CCPs.[431] They have implemented stricter risk management practices, particularly focused on stress events.

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[425] ibid.
[426] Group of 20 (G20), 'Declaration on Strengthening the Financial System-London Summit' (n 376).
[427] Domanski, Gambacorta and Picillo (n 135).
[428] Balmer (n 104).
[429] Nabilou and Asimakopoulos (n 104).
[430] Domanski, Gambacorta and Picillo (n 135).
[431] Wendt (n 107).

[432]Furthermore, they have adjusted capital and margin requirements for centrally cleared and non-centrally cleared products to ensure adequate coverage of risks associated with bank exposures to CCPs while maintaining incentives for central clearing.[433] Recently, attention has also turned to the issue of CCP recovery and resolution planning.[434]

4.2 The Role of the International Organization of Securities Commissions (IOSCO)

The IOSCO is an international organization that plays a crucial role in establishing standards for the securities industry.[435] What sets it apart from other organizations is the creation of the Multilateral Memorandum of Understanding (MMoU), a unique document designed to foster cooperation and information exchange.[436] The MMoU includes a screening group that assesses an applicant's ability to comply with the provisions outlined in the questionnaire.[437]

In the past, IOSCO took the initiative in developing international standards for securities regulation. However, its role gained significant importance following the 2008 financial crisis, as it became widely

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[432] Heath and others (n 24).
[433] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions (IOSCO), 'Margin Requirements for Non-Centrally Cleared Derivatives' (2015).
[434] Priem (n 175).
[435] International Organization of Securities Commissions IOSCO, 'Objectives and Principles of Securities Regulation' (2017) 1 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf> accessed 28 November 2023.
[436] Janet Austin, 'IOSCO and the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation. Investigating and Prosecuting Across Borders' in Janet Austin (ed), *Insider Trading and Market Manipulation* (Edward Elgar Publishing 2017).
[437] International Organization of Securities Commissions IOSCO, *Multilateral memorandum of understanding concerning consultation and cooperation and the exchange of information* (2002).

recognized as the global standard setter for securities regulation.[438] In response to the crisis, the G20 tasked IOSCO with developing standards, principles, and monitoring measures.[439] Nonetheless, these standards may have some limitations as they can be overly general, which restricts their influence on EU financial services legislation because the EU has a more specific approach.[440] However, IOSCO remains an influential standard setter.

The Secretary General of IOSCO has been advocating for global financial structure reform to promote regulatory convergence among G20 members and other countries.[441] The organization holds the privilege and responsibility of shaping regulatory landscapes in areas that lack regulation at either the national or international level.[442] However, this task is challenging, as major jurisdictions with existing regulations may attempt to extend their legislation to other countries.[443]

In the case of the EU, its participation in the IOSCO has presented complexities due to its various memberships.[444] Firstly, the Member States are represented in the IOSCO as Ordinary Members through their respective supervisory authorities.[445] Secondly, the ESMA holds an

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[438] Antonio Marcacci, *Transnational Securities Regulation*, vol 3 (Springer 2023).
[439] Antonio Marcacci, 'IOSCO Evolution, Nature and Governance' in *Transnational Securities Regulation* (Springer 2023).
[440] Pier Henri Conac, 'The European Union's Role in International Economic Fora Paper 6: The IOSCO', 12.
[441] International Organization of Securities Commissions IOSCO., 'Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting Building a Better Financial System: IOSCO's Role. Speech by Greg Tanzer, Secretary General' (2011), <https://www.iosco.org/library/speeches/pdf/IOSCOSP05-11.pdf> accessed 28 November 2023.
[442] International Organization of Securities Commissions IOSCO (n 435).
[443] Quaglia, *Eur. Union Glob. Financ. Regul.* (n 41).
[444] Antonio Marcacci, 'The EU in the Transnational Financial Regulatory Arena. The Case of IOSCO.' in Marise Cremona and Hans-W Micklitz (eds), *Private Law in the External Relations of the EU* (Oxford University Press 2016).
[445] Antonio Marcacci, 'The Involvement of Regulatory Powers in IOSCO' (2023).

Associate (non-voting) Membership in the IOSCO, hence, the ESMA is also part of the IOSCO.[446] This unique membership is possible because the EU possesses a supranational supervisory authority. Additionally, the European Commission is also an Associate (non-voting) Member of the IOSCO.[447]

The European Commission's participation in the IOSCO derives from its competence in financial services regulation, as stipulated in Article 3 of the TEU and Article 4 of the TFEU. These articles outline the areas of shared competence between the European Union and its Member States.[448] Financial services fall under the shared competence for the internal market.[449] This competence is more specifically exercised through provisions such as Article 50 (freedom of establishment), Article 53 (right of individuals to pursue self-employment), and Article 114 (approximation of laws related to the establishment and functioning of the internal market) of the TFEU.

There are specific provisions outlined in Article 218 of the TFEU that govern the negotiation of agreements between the EU and third countries or international organizations.[450] However, there is no explicit provision regarding the representation of the EU institutions (ESMA and European Commission) before the IOSCO.[451] Nonetheless, these institutions are empowered to act on behalf of the EU based on the EU's internal

[446] ibid.
[447] Conac (n 440).
[448] Rudolf Geiger, Daniel-Erasmus Khan and Markus Kotzur, 'Treaty on the Functioning of the European Union' in Rudolf Geiger, Daniel-Erasmus Khan and Markus Kotzur (eds), *European Union Treaties* (Online, Hart 2015).
[449] ibid.
[450] ibid.
[451] Marcacci, 'The EU in the Transnational Financial Regulatory Arena. The Case of IOSCO.' (n 444).

legislative capacity in financial services.[452] The Court of Justice of the European Union (ECJ) has established the doctrine of implied powers, which allows the EU to enter into binding international agreements in areas where it possesses internal competence, if necessary to achieve the objectives of the Treaty.[453] This doctrine is particularly relevant in the field of financial services, where the EU's level of intervention is substantial.[454]

However, since the IOSCO primarily produces soft law commitments instead of legally binding agreements, the ECJ has determined that the procedures outlined in Article 218 of the TFEU for binding international agreements do not apply in such cases.[455] Nevertheless, the role of the EU in the IOSCO remains crucial, not only due to its representation but also because the EU has implemented certain financial guidelines within the IOSCO framework.[456] Therefore, cooperation between these two institutions is of utmost importance in achieving financial convergence between third countries and the EU.

4.2.1 CRAs

Concerning CRAs, the Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO CRA Code) was published by IOSCO in 2004 as a response to the failures of CRAs in the Enron and WorldCom cases.[457] It established regulations to ensure the quality and integrity of the rating

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[452] Antonio Marcacci, 'The EU and IOSCO: An Ever Closer Cooperation?' Working Paper, EUI LAW, 2013/02, European Regulatory Private Law Project.

[453] *European Court of Justice, 14 July 1976, Joined cases 3, 4 and 6-76, Cornelis Kramer and others [1976] ECR 1279*.

[454] Piet Eeckhout, 'The Doctrine of Implied Powers' (2nd edn, Oxford Scholarship Online 2011).

[455] *European Court of Justice, 23 March 2004, Case C-233/02, French Republic v Commission [2004] ECR I-2759*.

[456] Marcacci, 'The EU in the Transnational Financial Regulatory Arena. The Case of IOSCO.' (n 444).

[457] Coffee Jr (n 84); International Organization of Securities Commissions IOSCO. Technical Committee, *Code of Conduct Fundamentals for Credit Rating* (2004).

process, including the monitoring of ratings, the implementation of appropriate internal procedures and guaranteed analyst independence to prevent conflicts of interest.[458] On the other hand, transparency in rating methods and the ability to make timely adjustments if necessary were other key aspects addressed in the Code as well as the handling of confidential information and the requirement to CRAs to disclose their adherence to the Code.[459] The rules outlined in that text are of a general nature and do not specify methodological details such as ratios, models, or rating categories.[460] These specifics are left to the discretion of the individual agencies, and there are valid reasons for this approach.[461]

It was expected that CRAs would either adopt the IOSCO Code into their own codes of conduct or provide a clear explanation for any aspects they chose not to adopt ("comply or explain" approach).[462] Compliance with the Code was monitored by competent authorities, but there were no specific mechanisms in place for imposing sanctions. By contrast, the Code served as an internationally recognized self-regulatory framework for the credit rating industry.[463] Consequently, the majority of CRAs, including the top three market leaders, implemented the Code, often in its entirety.[464]

Following the 2008 financial crisis, the IOSCO Chairman's Task Force on Credit Rating Agencies (CRA Task Force), which later became the Committee on Credit Ratings (Committee 6 (C6), conducted a study on

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[458] Utzig (n 42).
[459] International Organization of Securities Commissions IOSCO. Technical Committee, *Code of Conduct Fundamentals for Credit Rating* (n 457).
[460] Utzig (n 42).
[461] Blaurock (n 48).
[462] Utzig (n 42).
[463] Fabian Dittrich, 'The Credit Rating Industry: Competition and Regulation' (2007).
[464] Everling and Trieu (n 24).

the role of CRAs in the structured finance market.[465] The findings of this study were released in a report that included various recommendations to revise the IOSCO CRA Code, which were implemented alongside the report's publication.[466] These revisions aimed to address concerns raised in the study, such as the quality of information used by CRAs, the timeliness of rating reviews and downgrades, and potential conflicts of interest when CRAs advise issuers on designing structured finance products.[467] As a result of these recommendations, an updated version of the IOSCO CRA Code, known as "the 2008 Code", was published in May 2008.[468]

In 2009, the CRA Task Force conducted a review to assess the extent to which CRAs had implemented the IOSCO CRA Code, including the 2008 revisions. The review results indicated that several CRAs, including the three largest ones (Fitch Ratings, Inc., Moody's Investors Service, Inc., and Standard & Poor's Rating Services), had substantially implemented the IOSCO CRA Code.[469] Only a few CRAs reviewed were found to have not implemented the IOSCO CRA Code in a meaningful manner.[470] The CRA Task Force was transformed into a permanent committee on Credit Rating Agencies (C6) by IOSCO in May 2009.[471]

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[465] Technical Comittee of International Organization of Securities Commissions (IOSCO) (n 49).
[466] ibid.
[467] Rousseau (n 49).
[468] International Organization of Securities Commissions IOSCO. Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies (May 2008)' (n 46).
[469] International Organization of Securities Commissions IOSCO. Technical Committee, 'A Review of Implementation of the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies' (2009).
[470] ibid.
[471] International Organization of Securities Commissions IOSCO. Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies (May 2008)' (n 46).

In response to the establishment of CRA registration and oversight programs between 2006 and 2010, IOSCO released a report in 2010 that presented the findings of C6's assessment of the implementation of CRA laws and regulations by regional and national authorities.[472] The report concluded that, although the regulatory programs may vary in structure and specific provisions, they all incorporate the objectives outlined in the four IOSCO CRA Principles.

In 2012, IOSCO released a survey report with the purpose of enhancing public awareness regarding the internal mechanisms of CRAs and enabling them to compare their own internal controls and procedures with those of other CRAs.[473] Following the 2012 report, in July 2013, IOSCO issued a conclusive report that proposed the establishment of supervisory colleges for select globally operating CRAs.[474] These supervisory colleges, comprised of relevant authorities, held their first meetings on November 5-6, 2013 in New York for Fitch, Moody's, and S&P.[475] The U.S. Securities and Exchange Commission chairs the colleges for S&P and Moody's, while the European Securities and Markets Authority chairs the college for Fitch.[476]

In February 2014, IOSCO released proposed revisions to the IOSCO CRA Code to account for the supervision of CRAs by regional and national authorities, referred to as the "Consultation Report." After considering

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[472] International Organization of Securities Commissions IOSCO. Technical Committee, 'Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies. Final Report' (2011).
[473] Board of the International Organization of Securities Commissions (IOSCO), 'Credit Rating Agencies : Internal Controls Designed to Ensure the Integrity of the Credit Rating Process and Procedures to Manage Conflicts of Interest' (2012).
[474] Board of the International Organization of Securities Commissions (IOSCO), 'Supervisory Colleges for Credit Rating Agencies. Final Report' (n 377).
[475] Dao, Godwin and Ramsay (n 23).
[476] International Organization of Securities Commissions IOSCO. Technical Committee, 'Code of Conduct Fundamentals for Credit Rating Agencies (May 2008)' (n 46).

public feedback on the Consultation Report, the Final Report introduces the new IOSCO CRA Code.[477] The objective of the new code was to align with CRA registration and oversight programs while continuing to serve as the international standard for CRA self-governance.[478] The revisions drew on the experience of IOSCO members in supervising CRAs and are influenced by the work conducted by C6, including a survey report on key risk controls implemented by CRAs and measures to manage conflicts of interest.[479] As part of the revision process, C6 surveyed its member jurisdictions and 26 CRAs based in specific countries to assess any discrepancies between the IOSCO CRA Code and local laws, as well as identify areas for improvement.[480] It concluded with the release of a New IOSCO CRAs Code in 2015.[481]

4.2.2 CCPs

Concerning CCPs standards the IOSCO has a very important role as well. A CCP has the potential to significantly reduce risks for market participants by implementing robust risk controls on all participants and enabling multilateral netting of trades.[482] It also has the ability to enhance market liquidity by reducing risks for participants and facilitating anonymous trading.[483] However, a CCP also concentrates risks and holds the responsibility for risk management; therefore, the effectiveness of a

[477] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies. 2014 Version' (2014).
[478] ibid.
[479] Cally E Jordan, 'International Financial Standards: An Argument for Discernment' (2018) 135.
[480] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies. 2014 Version' (n 477).
[481] Board of the International Organization of Securities Commissions (IOSCO), 'Code of Conduct Fundamentals for Credit Rating Agencies (March 2015) FR05/2015' (n 5).
[482] Priem (n 175).
[483] Committee on Payment and Settlement Systems (CPSS) and Technical Comittee of International Organization of Securities Commissions (IOSCO) (n 124).

CCP's risk controls and the adequacy of its financial resources are crucial for the functioning of the markets it serves.[484]

If a CCP fails in its risk management, it has the potential to disrupt the markets it serves as well as other components of the settlement systems associated with the traded instruments.[485] These disruptions can even extend to payment systems and other settlement systems. Given the potential impact on securities and derivatives markets, as well as payment and settlement systems, securities regulators and central banks have a vested interest in ensuring effective CCP risk management.[486]

In November 2001, the CPSS and the Technical Committee of the IOSCO released a report called "Recommendations for Securities Settlement Systems" (RSSS).[487] Among the recommendations, Recommendation 4 specifically addressed CCPs and called for a thorough evaluation of the benefits and costs of a CCP, along with rigorous risk control measures.[488] However, it did not provide detailed or comprehensive standards for CCP risk management.[489] Other recommendations were also relevant to CCPs, covering areas such as operational reliability, efficiency, governance, transparency, regulation, and oversight.

Recognizing the significant role of CCPs in securities settlement systems and the potential for risk management failures to disrupt markets and payment and securities settlement systems, the CPSS and IOSCO concluded that detailed and comprehensive international standards for

[484] Lewis (n 117).
[485] Braithwaite and Murphy (n 123).
[486] Menkveld (n 208).
[487] Committee on Payment and Settlement Systems (CPSS) and Board of the International Organization of Securities Commissions (IOSCO) (n 377).
[488] ibid.
[489] Russo and others (n 149).

CCP risk management were necessary.[490] In February 2003, they instructed their Task Force on Securities Settlement Systems to develop these standards, addressing various types of risks faced by CCPs.[491] The Task Force incorporated relevant work from private and public sector bodies, including the European Association of Central Counterparty Clearing Houses (EACH) and CCP-12, a group representing CCPs from Asia, the Americas, and Europe.[492]

4.3 The Role of the Financial Stability Board (FSB)

The FSB is comprised of representatives from governmental agencies, central banks, and international organizations such as the Bank for International Settlements, the Basel Committee on Banking Supervision, CPMI, the International Association of Insurance Supervisors, the International Monetary Fund, and IOSCO.[493]

In contrast to IOSCO's formal universal membership, the Financial Stability Board (FSB) operates as an "umbrella organization"[494] or a "network of networks"[495] consisting of 25 members, including the European Union represented by the European Commission and the

[490] Committee on Payment and Settlement Systems (n 147).

[491] Committee on Payment and Settlement Systems (CPSS), 'Market Structure Developments in the Clearing Industry: Implications for Financial Stability. Report of the Working Group on Post-Trade Services' (2010).

[492] Committee on Payment and Settlement Systems (CPSS) and Board of the International Organization of Securities Commissions (IOSCO) (n 377).

[493] Financial Stability Board (FSB), 'About the FSB' (2020).

[494] Gadinis (n 379).

[495] Abraham L. Newman and David Zaring, 'Regulatory Networks: Power, Legitimacy, and Compliance' in Jeffrey L Dunoff and Mark A Pollack (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of Art* (Cambridge University Press 2013); Chris Brummert, 'Post-American Securities Regulation' (2010) 98 California Law Review 327.

European Central Bank.[496] The European Commission and the European Central Bank participate as Member Jurisdictions.[497]

Its primary objectives are to assess vulnerabilities in the global financial system, identify necessary actions to address them, promote coordination and information exchange among authorities responsible for financial stability.[498] On the other hand, the FSB, being a collaborative body consisting of various organizations, has played a significant role in establishing standards to address the issues raised during the G20 meetings.[499] Each of these organizations has contributed by developing standards within their respective areas of expertise.[500]

Furthermore, recognizing the critical significance of CRAs and CCPs during and after the crisis, the FSB has been compelled to take decisive action with regard to both services. For instance, in 2007, the G7 Ministers and Central Bank Governors initiated a global effort in response to the financial crisis by requesting the FSB to examine the causes and vulnerabilities that led to the market turmoil.[501] Their objective was to propose measures to enhance market and institutional resilience. It was the first worldwide initiative to analyze the financial turmoil and propose solutions.[502]

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[496] Antonio Marcacci, *IOSCO in the International Financial Architecture* (2023).
[497] Financial Stability Board (FSB), 'FSB Framework for Strengthening Adherence to International Standards Revised'.
[498] Domenico Lombardo, 'The Governance of the Financial Stability Board' (2011).
[499] Eric Helleiner, 'The Financial Stability Board and International Standards' (2010) 1 CIGI G20 Papers 1.
[500] ibid.
[501] Group of seven (G7) Finance Ministers and Central Bank Governors, 'Statement by G-7 Finance Ministers and Central Bank Governors on Global Financial Market Turmoil' (2008).
[502] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).

Consequently, in April 2008, the FSB released a report that focused on areas such as strengthening prudential oversight of capital, liquidity, and risk management, improving transparency and valuation, enhancing authorities´ risk response capabilities, establishing robust frameworks for managing financial system stress, and addressing issues related to the role and use of credit ratings.[503] The findings and recommendations presented in this report were diligently compiled through a collaborative endeavor involving major international bodies and national authorities in important financial hubs. A vast body of coordinated work, encompassing contributions from the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), the Joint Forum, the International Accounting Standards Board (IASB), the Committee on Payment and Settlement Systems (CPSS), the Committee on the Global Financial System (CGFS), the International Monetary Fund (IMF), the Bank for International Settlements (BIS), and national authorities in key financial centers, contributed to these insights. Moreover, valuable input was collected from private sector market participants.[504]

4.3.1 CRAs

The "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience" in 2008 emphasized the significance of their role in assessing information on structured financial products and the trust investors place in their ratings.[505] To address the weaknesses identified

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[503] Financial Stability Forum (FSF) currently Financial Stability Board (FSB) (n 378).
[504] ibid.
[505] Eichengreen (n 215).

during the crisis, the FSB put forth recommendations based largely on inputs from IOSCO and the Committee of Global Financial System.[506]

In July 2008, the CGFS released a paper titled "Ratings in structured finance: what went wrong and what can be done to address shortcomings?" aiming to enhance the reliability of ratings for structured finance products.[507] The paper offered several recommendations to tackle the identified weaknesses. This report was commissioned by the FSF to update the CGFS's previous analysis on the role of ratings in structured finance, which was published in January 2005 under the title "The role of ratings in structured finance: issues and implications".[508]

Concurrently, in response to the FSB's requests, the IOSCO's Code of Conduct was revised and updated, leading to its transformation into the "2008 Code."[509]

Then, during the 2009 consensus among G20 leaders, the Financial Stability Forum (FSF) became the Financial Stability Board (FSB) and a significant milestone was achieved with the establishment of a comprehensive reform agenda for OTC derivatives markets as well as CRAs.[510] This agenda aimed to tackle crucial objectives, including the improvement of transparency, the reduction of systemic risk, and the prevention of market abuse in order to foster a more resilient and secure financial system.[511] To achieve these goals, the G20 agreed on the

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[506] Financial Stability Forum (FSF) currently Financial Stability Board (FSB) (n 378).
[507] Committee on the Global Financial System (n 381).
[508] Committee on the Global Financial System, 'The Role of Ratings in Structured Finance: Issues and Implications' (2005).
[509] See Chapter IV, section 4.2.
[510] Financial Stability Board (FSB), 'Improving Financial Regulation: Report of the Financial Stability Board to G20 Leaders' (n 379).
[511] Financial Stability Board (FSB), 'Overview of Progress in Implementing the London Summit Recommendations for Strengthening Financial Stability: Report of the Financial Stability Board to G20 Leaders' (n 379).

following measures: reporting all OTC derivatives contracts TRs, clearing standardized contracts through CCPs, trading standardized contracts on exchanges or electronic platforms when appropriate, and imposing higher capital and margin requirements for non-centrally cleared (bilateral) contracts.[512]

In light of its enhanced role in coordinating and monitoring financial regulation, the FSB develops reports before each G-20 summit, presenting a comprehensive assessment of the advancements made in adopting G-20 recommendations from previous meetings. As part of these regular assessments, the FSB has been closely monitoring the measures taken by national and regional authorities to mitigate excessive reliance on ratings in their regulatory frameworks. To facilitate this objective, the FSB released the "Principles for Reducing Reliance on CRA Ratings" in October 2010, intended to aid authorities in reducing their reliance on ratings.[513]

4.3.2 CCPs

In the context of CCPs, one of the notable achievements of the FSB has been the formulation of the Principles for Financial Market Infrastructures.[514] These principles were jointly produced in 2012 by the Technical Committee of the CPSS, the IOSCO, and the Bank for International Settlements. The collective efforts of these organizations have resulted in the development of comprehensive guidelines aimed at

[512] Financial Stability Board (FSB), 'Improving Financial Regulation: Report of the Financial Stability Board to G20 Leaders' (n 379).
[513] Financial Stability Board (n 379).
[514] Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS) (n 102).

enhancing the stability and resilience of financial market infrastructures which are still ongoing.[515]

In fact, during the February 2015 gathering of Finance Ministers and Central Bank Governors within the G20, a new request was made to the FSB to collaborate with CPMI, IOSCO, and BCBS in creating a comprehensive work plan aimed at fostering the resilience, recovery planning, and resolvability of CCPs.[516]

To facilitate the implementation of these reforms, the FSB and other international standard-setting bodies have established standards and guidelines for financial market infrastructures (FMIs) and market participants.[517] The FSB has focused on resolving FMIs, particularly CCPs, while the CPMI and IOSCO have worked on enhancing the resilience and recovery of CCPs and other FMIs.[518]

4.4 The Exclusive Role of the Committee on Payments and Market Infrastructures (CPMI) in CCPs regulation

The Committee on Payment and Settlement Systems (CPSS) was founded by the G10 Governors as a permanent central bank committee under the G10 Governors' oversight, along with other key committees like the Basel Committee on Banking Supervision and the Committee on the Global Financial System (CGFS).[519] In September 2013, due to the increased public attention resulting from the Committee's role in setting standards, the CPSS conducted a review of its responsibilities and decided to rename the CPSS as the Committee on Payments and Market Infrastructures

[515] Ferrarini and Saguato (n 119).
[516] Financial Stability Board (FSB) and others (n 379).
[517] Ferrarini and Saguato (n 120).
[518] Donnelly and Wessel (n 242).
[519] Bank for International Settlements (BIS), 'History of the CPMI' <https://www.bis.org/cpmi/history.htm?m=3066> accessed 28 November 2023.

(CPMI), it was approved by the Global Economy Meeting (GEM) that replaced the G10 Governors.[520]

The CPMI is comprised of esteemed representatives from central banks around the globe which objective is to offer recommendations pertaining to the safety and efficiency of payment, clearing, settlement, and associated systems.[521] Moreover, the CPMI functions as a forum for facilitating cooperation among central banks, addressing matters like oversight, policy formulation, and operational considerations.[522] It is important to note that the scope of the CPMI is limited to CCPs and does not extend to CRAs.

The Chairs of various FSB Committees, including the IOSCO and CPMI, jointly proposed the 2015 CCP workplan to the FSB Steering Committee.[523] The main focus areas determined by the Chairs of these Committees concern to the strength and stability of CCPs, their recovery planning, and their ability to be resolved effectively.[524]

The guidelines pertaining to CCPs are primarily a collaborative effort between the CPMI and IOSCO, showcasing their commitment to working together in addressing critical aspects of CCPs. Furthermore, CPMI-IOSCO is the main platform responsible for addressing the priorities related to the resilience and recovery of CCPs.[525] Hence, the most important documents in this area are the "Principles for Financial Market

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[520] ibid.
[521] Committee on Payments and Market Infrastructure, 'Charter' (2014).
[522] ibid.
[523] Financial Stability Board (FSB) and others (n 379).
[524] ibid.
[525] International Organization of Securities Commissions IOSCO Board and Committee on Payments and Market Infrastructures (CPMI) (n 2).

Infrastructures (PFMI)" and the "Resilience of Central Counterparties (CCPs): Further Guidance on the PFMI".

Another important committee is the Policy Standing Group (PSG), a standing working-level group established by the CPMI-IOSCO Steering Group which carries out the work in the area of resilience and recovery.[526] After reviewing the findings, it was determined that certain standards within the PFMI would benefit from more detailed guidance to facilitate enhanced implementation by CCPs and strengthen their overall resilience.[527]

4.5 The Basel Committee on Banking Supervision's Impact on Credit Rating Agencies (CRAs) Regulation

The Basel Committee on Banking Supervision plays a significant role in shaping the landscape of financial regulation, particularly for banks. While it may not be directly responsible for promoting standards for CRAs, its influence in the context of external ratings cannot be overlooked. This influence is especially relevant and pertinent to the focus of this dissertation, as it delves into the ratings used for regulatory purposes.

External ratings, in contrast to internal ratings formulated by banks, are provided by CRAs but used in bank capital regulation.[528] In response to the crucial role of external ratings in financial markets, the Basel Committee on Banking Supervision has proactively developed recommendations aimed at improving their usage through the Basel

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[526] ibid.
[527] ibid.
[528] Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92).

Accords.[529] These recommendations have a direct influence on the regulation and supervision of CRAs in the EU.

This is because Basel II placed significant importance on external ratings, including those provided by rating agencies, to assess credit risks.[530] Indeed, the Basel Committee initially suggested that banks should have the option to choose between different methods for calculating credit risk capital requirements: the first using an internal rating system for credit risk subject to approval by the supervising institution, and the second, using a standardized approach with external credit assessments.[531]

By contrast, as a response to the financial crisis of 2007-09, the completion of the Basel III reforms seeks, among other objectives, to decrease dependence on external ratings in the credit risk framework.[532] These recommendations have been partially integrated into the EU's regulatory framework through the implementation of the Capital Requirements Regulation (EU) No. 575/2013 and the Credit Institutions Directive 2013.[533]

Despite the efforts made to implement the Basel III reforms in the EU, there are some criticisms regarding their impact on external ratings. One of the main concerns is that while Basel III reforms aim to reduce reliance on external ratings in the credit risk framework, it can be stated that it does not provide clear and specific guidelines on how financial institutions

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[529] Basel Committee on Banking Supervision, 'Credit Ratings and Complementary Sources of Credit Quality Information (July 2000)' (n 60).

[530] Basel Committee on Banking Supervision, 'Basel II-International Convergence of Capital Measurement and Capital Standards A Revised Framework' (2004).

[531] Basel Committee on Banking Supervision, 'International Convergence of Capital Measurement and Capital Standards. A Revised Framework' (2004). Part 2, sections II and III.

[532] Basel Committee on Banking Supervision, 'High-Level Summary of Basel III Reforms' (2017).

[533] European Banking Authority (EBA), 'Report on Reliance on External Credit Ratings' (2021).

should develop their internal risk assessment models to replace external ratings. Hence, while the intentions behind Basel III to lessen the dependence on external ratings are laudable, there are concerns about the clarity of guidance for internal risk models and potential unintended consequences.

5 Navigating the Regulatory Landscape: Financial Regulation in the EU Context

The regulation of financial services in the EU has evolved gradually as a result of various events, shaping it into a step-by-step process. This dissertation focuses on the financial crisis of 2007-08 as the starting point, as the selected financial services of this research, namely Credit Rating Agencies (CRAs) and Central Counterparties (CCPs), gained significant importance during that crisis.[534]

The regulation of these two services was carefully chosen for this study due to their significant reliance on third-country participants who offer these services within the EU. After the financial crisis, both services have gained substantial importance, and their regulation has taken into account the necessity of integration with multiple countries.[535] This aspect holds particular relevance within the EU, which already operates its internal market and faces challenges regarding the regulation of financial services with cross-border elements within the Union.

The regulation of financial services, particularly concerning CRAs and CCPs, within the EU has been influenced by numerous factors. In the

[534] In this context, the terms "regulation" and "supervision" are used interchangeably, referring to the oversight and control of risks or conduct based on a set of standards. These processes involve various strategies, such as monitoring, registration, and the application of penalties.
[535] Kern Alexander and Vivienne Madders, 'Financial Market Regulation in the Internal Market', *The EU Law of Economic and Monetary Union* (2020).

context of this research, which focuses on third-country CRAs and CCPs, two crucial determinants emerge as the main drivers of the third-country regime. The first stage involves the harmonization of national laws pertaining to these financial services. This process aimed to create a unified regulatory framework across EU member states, ensuring consistency and cooperation in the oversight of CRAs and CCPs.[536]

The second stage was triggered by the financial crisis that unfolded between 2007 and 2008. This crisis highlighted the need for stronger regulatory measures to address vulnerabilities within the financial system.[537] Consequently, it prompted a reassessment of the regulatory and supervisory framework surrounding CRAs and CCPs in the EU. This period of financial turmoil led to the implementation of reforms and the introduction of more robust regulations to mitigate risks, enhance transparency, and safeguard the stability of the financial sector.

Moreover, the interaction with third countries was viewed as a potential risk in itself, particularly in the aftermath of the crisis that originated in the US and had far-reaching spillover effects. As a result, it significantly altered the perception of regulating third-country financial services providers.

5.1 Striving for Unity: The Role of Harmonizing Member States' Laws in Financial Regulation

The regulation of financial services within the EU began with the integration of rules and enforcement mechanisms into the existing

[536] Valia SG Babis, 'Single Rulebook for Prudential Regulation of EU Banks: Mission Accomplished?' (2015) 26 European Business Law Review 779.
[537] Pieter Van Cleynenbreugel, 'EU Post-Crisis Economic and Financial Market Regulation. Embedding Member States' Interests Within "More Europe"' in Marton Varju (ed), *Between Compliance and Particularism. Member State Interests and European Union Law* (Springer 2019).

legislative frameworks of Member States.[538] This approach aimed to establish a harmonized regulatory framework and ensure consistent standards across the EU. The goal was to facilitate the free movement of financial services, promote competition, and foster a level playing field for market participants.[539] By aligning regulations and enforcement practices, the EU sought to create a more efficient and integrated financial system.[540]

Consequently, financial regulation has been an integral part of the EU internal market's development since the publication of the 1985 White Paper by the European Commission.[541] However, it was not until 1999 that the Commission introduced its Financial Services Action Plan (FSAP) and proposed an expansion of EU regulations in this area.[542] The FSAP outlined 42 regulatory measures aimed, in principle, at achieving the integration of national financial markets.[543]

In response to this demand, the EU institutions undertook significant efforts between 2002 and 2007 to strengthen the regulatory framework for banking, securities, and insurance transactions.[544] This involved introducing a comprehensive set of regulations that built upon existing legal frameworks and replaced Member States' rules with harmonized

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[538] ibid.

[539] Panagiotis Tridimas, 'EU Financial Regulation: Federalization, Crisis Management and Law Reform' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (2nd edn, Oxford University Press 2011).Bergström (n 236).

[540] Kern Alexander, 'Financial Market Integration and EMU' in Fabian Amtenbrink and Christoph Herrmann (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020).

[541] European Commission, 'Commission's White Paper on the Completion of the Internal Market' (1985), COM 85(310).

[542] European Commission, Commission Communication entitled "Implementing the framework for financial markets: action plan", 11 May 1999, COM (1999) 232 final.

[543] ibid.

[544] Michel Tison, *Financial Market Integration in the Post FSAP Era. In Search of Overall Conceptual Consistency in the Regulatory Framework* (Guido Ferrarini and Eddy Wymeersch eds, Oxford Scholarship Online 2009).

regulations.[545] The proposals outlined in the FSAP materialized into various regulatory measures aimed at enhancing transparency obligations for publicly traded company shares, standardizing rules for insider trading at the EU level, improving transparency in the preparation and publication of prospectuses, and regulating financial instruments in secondary markets.[546] To ensure effective implementation, each legislative instrument was further supported by specific implementing directives and regulations, which provided more detailed and specific guidelines.[547]

The harmonization of national laws has been a critical aspect of financial regulation in the EU, especially given the complex and interconnected nature of financial services. While the initial focus of harmonization was on creating a unified regulatory framework within the EU, it has also become crucial for facilitating the integration of third-country providers into the EU single market. The harmonization efforts have aimed to standardize rules and requirements across member states, allowing for a seamless and consistent regulatory environment that benefits both domestic and third-country actors.

In the case of CRAs and CCPs, it could be stated that the harmonization of national laws has been significant in creating instruments such as equivalence or endorsement that enable third-country providers to access the entire EU single market.[548] These instruments were carefully designed to ensure that they work cohesively across all Member States, avoiding fragmentation.[549] Therefore, harmonization has played a pivotal role in

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[545] Tridimas (n 539).
[546] Tison (n 544).
[547] Lucia Quaglia, *Governing Financial Services in the European Union : Banking, Securities and Post-Trading* (Routledge 2010).
[548] Young (n 303).
[549] Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21).

making them effective gateways to the EU market, rather than restricted to the market of a single Member State.[550] Nevertheless, despite the efforts towards harmonization of financial regulations in the EU, it can be difficult.[551] Moreover, equivalence and endorsement can often be lengthy and intricate, leading to uncertainty and delays for financial service providers.[552] As a result, some third-country services may find the process burdensome and opt for direct negotiations with individual Member States instead.

5.2 Piloting Turmoil: The Impact of Financial Crises on EU Financial Regulation Reforms

The occurrence of financial and sovereign debt crises within the European Union between 2008 and 2014 led to significant institutional and governance reforms at the EU level.[553] Prior to the crises, the European Union (EU) had already recognized the need to enhance its regulation regarding financial services as a crucial component of its internal market.[554]

The global financial crisis presented an opportunity to expand and restore the existing financial regulatory framework.[555] At the EU level, the De

[550] Jerome Jean Deslandes, Cristina Dias and Marcel Magnus, 'Third Country Equivalence in EU Banking and Financial Regulation' (*In depth analysis*, 2019) <https://www.europarl.europa.eu/thinktank/en/document.html?reference=IPOL_IDA %282018%29614495> accessed 28 November 2023.
[551] Hill, 'Regulatory Cooperation in Securities Market Regulation: Perspectives from Australia' (n 326).
[552] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[553] Dimitrios Asteriou and Konstantinos Spanos, 'The Relationship between Financial Development and Economic Growth during the Recent Crisis Evidence from the EU' (2019) 28(C) Finance Research Letters 238.
[554] Niamh Moloney, 'EU Financial Market Regulation after the Global Financial Crisis: "More Europe" or More Risks?'' (2010) 47 Common Market Law Review 1317.
[555] Eric J Pan, 'Structural Reform of Financial Regulation' (2011) 19 Transnational Law & Contemporary Problems 796.

Larosière Report of 2009 acknowledged the institutional weaknesses of the current system and proposed innovative institutional arrangements within the EU.[556] In response to this report, the European Commission expressed support for the establishment of new EU supervisory agencies in a communication on European financial supervision.[557] Subsequently, the Commission successfully persuaded the Council and the European Parliament to adopt its legislative proposals.

The EU worked on two levels. On a macroeconomic level, the European Union established the European Systemic Risk Board (ESRB), chaired by the President of the European Central Bank (ECB).[558] The ESRB consists of various entities, including the General Board, the Steering Committee, the Secretariat, the Advisory Scientific Committee, and the Advisory Technical Committee.[559] The Steering Committee plays a crucial role in organizing the meetings of the General Board, where concrete supervisory decisions are made.[560] The primary task of the ESRB is to monitor and assess systemic risk; however, it lacks the authority to make binding decisions.[561]

At the micro-supervisory level, the regulatory overhaul resulted in the creation of three European Supervisory Authorities (ESAs): the European Banking Authority (EBA), the European Insurance and Occupational

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[556] de Larosière and others (n 201).
[557] European Commission, "Communication from the Commission - European Financial Supervision", 27 May 2009, COM (2009) 252 final, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52009DC0252> accessed 28 November 2023.
[558] Masahiro Kawai and Michael Pomerleano, ‘Regulating Systemic Risk’ in Asli Demirgüç-Kunt, Douglas D Evanoff and George G Kaufman (eds), *The International Financial Crisis. Have the Rules of Finance Changed?* (World Scientific Publishing Co Pte Ltd 2011).
[559] Michael Ehrmann and Paul Schure, ‘The European Systemic Risk Board–Governance and Early Experience’ (2020) 23 Journal of Economic Policy Reform 290.
[560] Eilís Ferran and Kern Alexander, ‘Can Soft Law Bodies Be Effective? The Special Case of the European Systemic Risk Board’ (2010) 35 European Law Review 751.
[561] Ehrmann and Schure (n 559).

Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA).[562] These supranational micro-supervision authorities served as improved successors to the previous committees comprised of national supervisory authorities, which were not part of the EU's institutional architecture.[563] The ESAs have been explicitly endowed with EU legal personality.[564] They possess coordinating powers, can draft implementing legislation and the technical standards incorporated within it, and, subsidiarily, are authorized to directly intervene in market supervision tasks.[565] ESMA, in particular, was granted specific decision-making and sanctioning powers concerning credit rating agencies and short selling transactions.[566]

After the establishment of the new institutional structures, the EU proceeded with the further development of its substantive legal framework. This involved the introduction of new regulations concerning capital requirements for credit institutions and insurance companies, alternative investment fund management, credit rating agencies, and

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[562] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ [2010] L 331/12, 15.12.2010; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ [2010] L 331/48, 15.12.2010; and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ [2010] L 331/84, 15.12.2010.

[563] Pierre Schammo, 'EU Day-to-Day Supervision or Intervention-Based Supervision: Which Way Forward for the European System of Financial Supervision?' (2012) 32 Oxford Journal of Legal Studies 771.

[564] Jennifer Payne, 'The Institutional Design of Financial Supervision and Financial Stability', *The EU Law of Economic and Monetary Union* (2020).

[565] Marta Simoncini, 'Legal Boundaries of European Supervisory Authorities (ESAs) in the Financial Markets' (2015) 34 Yearbook of European Law yev023.

[566] Carmine Di Noia and Matteo Gargantini, *The European Securities and Markets Authority: Accountability Towards EU Institutions and Stakeholders* (2013).

over-the-counter transactions in derivatives.[567] Additionally, rules were implemented to prohibit short selling transactions, which complemented the extensive framework already established under the FSAP framework.[568] Furthermore, the European Commission put forward a proposal for a deposit guarantee scheme at the euro area level, aiming to complement and partially replace existing national schemes.[569] All of these legislative measures are part of the EU's endeavor to create and uphold a unified set of regulations, known as the single rulebook, for financial services in the internal market.[570]

The financial crises not only left a profound impact on the global economy but also triggered a shift in the way the EU approached its relations with third countries in the field of financial services, starting a new era of unprecedented challenges and opportunities.[571] As a result, the EU found itself compelled to redefine its regulatory approach when it came to engaging with third countries.[572] This shift in approach marked a significant exit from the regulatory practices of the pre-crisis era. However, among these changes, certain aspects have remained

[567] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010; Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.
[568] Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps.
[569] European Commission, Proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes, COM (2010) 368 final, 12 July 2010.
[570] Asen Lefterov, 'The Single Rulebook : Legal Issues and Relevance' [2015]; Babis (n 536).
[571] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[572] Domenica Tropeano, 'Financial Regulation After the Crisis: Where Do We Stand?' (2011) 40 International Journal of Political Economy 45.

consistent, demonstrating a continuity in the EU's regulatory framework.[573]

5.3 Regulatory Regimes for CRAs and CCPs

Regulatory frameworks progress at diverse speeds, often triggered by a mix of crises, political agendas, and ideologies.[574] During the 1980s, discussions and debates surrounding financial regulation were largely influenced by economic liberalism.[575] Consequently, the prevailing perspective focused on the idea of liberating markets from excessive state intervention, and the discourse often revolved around the simplistic and misleading distinctions of "regulation versus deregulation" or "self-regulation versus government regulation."[576] These approaches failed to capture the nuanced and complex nature of financial regulation during that period.[577]

However, the debate now extends to explore various regulatory strategies that can be employed and how businesses adapt to different regulatory frameworks.[578] Regulators have adopted different terms to describe distinct approaches in designing and implementing regulatory frameworks, which include principles-based regulation (PBR), management-based regulation, outcome-focused regulation, risk-based regulation, judgement-based regulation, and 'credible deterrence'.[579]

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[573] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[574] Julia Black, 'Regulatory Styles and Supervisory Strategies' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (2015).
[575] Kern Alexander, 'The World Trade Organization and Financial Stability: The Balance between Liberalisation and Regulation in the GATs' (2003) 1 CFAP Working Papers.
[576] Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21).
[577] Markus Brunnermeier and others, 'The Fundamental Principles of Financial Regulation' (2009) 11.
[578] Robert Baldwin, Martin Cave and Martin Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (Oxford Academic 2015).
[579] Black (n 574).

Nevertheless, the diversity of terms does not imply that all these approaches are mutually exclusive or that one is inherently superior to others. Two terms that hold significant importance for the regulation of CRAs and CCPs are principles-based regulation and risk-based regulation.

On the one hand, a principle-based regulatory or supervisory approach, as the name suggests, relies on principles to guide decision-making and actions. Such an approach allows for greater adaptability to specific local contexts and enables customized implementations to address unique circumstances effectively. This flexibility can be advantageous as it allows regulators and supervisors to take into account the diversity of financial systems and institutions while still adhering to the overarching principles. Indeed, the majority of international standards governing financial services are characterized as soft law. On the other hand, a risk-based approach prioritizes risks over rigid rules. Rather than focusing solely on enforcing a set of predetermined rules, risk-based frameworks require regulators to identify and manage specific risks. Hence, they often face an overwhelming number of rules that cannot be enforced uniformly across all firms at all times. Consequently, choices must be made regarding which rules to prioritize.

Furthermore, the current financial regulation surrounding CRAs and CCPs cannot be strictly confined to just one regulatory approach due to the following reasons. Firstly, the regulatory and supervisory landscape for these financial services has undergone significant changes and updates in recent years, resulting in a dynamic and evolving framework.[580] Various modifications and amendments have been introduced to address emerging challenges and align with international standards.

[580] Quaglia, *Eur. Union Glob. Financ. Regul.* (n 41).

Additionally, new instruments and approaches have been incorporated into the regulation to allow third-country CRAs and CCPs in the EU. One notable example is the emergence of equivalence-based regulation, which has gained attention as a potential new approach to enhance cross-border cooperation and recognition of regulatory regimes.[581] Furthermore, in principle, the third-country provisions often followed an outcomes-based approach, evaluating the similarity of regulatory and supervisory outcomes rather than seeking an exact match of legal texts.[582] However, given the prevailing regulations, it can be concluded that standards relating to third-country CRAs and CCPs fall mainly into two distinct categories. Firstly, the risk-based approach aligns with the shared objective of EU regulations for both CRAs and CCPs, which primarily focuses on maintaining financial stability and preventing systemic risk.[583] Secondly, the principle-based regulation draws from the international legal frameworks that have been established, as both CRAs and CCPs adhere to principles such as the IOSCO Code of Conduct and the Principles on Financial Market Infrastructures respectively.[584]

6 Conclusion

The analysis of the global regulatory landscape of CRAs and CCPs has revealed a complex and interconnected web of initiatives, institutions, and challenges. Throughout this chapter, we have witnessed the efforts of international bodies such as the G20, the FSB, the IOSCO and the CPMI in shaping the regulation of CRAs and CCPs on a global scale. The

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[581] Dao, Godwin and Ramsay (n 23).
[582] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).
[583] Danny Busch and Mirik BJ van Rijn, *Towards Single Supervision and Resolution of Systemically Important Non-Bank Financial Institutions in the European Union*, vol 19 (Springer International Publishing 2018); Darbellay (n 63).
[584] Pablo Iglesias-Rodríguez, 'Very Old Not Updated The Regulation of Cross-Border Clearing and Settlement in the European Union from a Legitimacy Perspective' (2012) 13 European Business Organization Law Review 441; Brunnermeier and others (n 577).

development of principles-based and risk-based approaches has aimed to enhance financial stability, investor protection, and market efficiency, while accommodating the unique circumstances of individual jurisdictions.

Furthermore, we explored the EU's response to the global financial crisis, which led to a substantial strengthening of the regulatory framework governing CRAs and CCPs. The EU's implementation of the Credit Rating Agencies Regulations (CRAS) and the European Market Infrastructure Regulation (EMIR) exemplifies its commitment to ensuring robust and consistent oversight of these critical financial services.

However, challenges persist, particularly concerning the extraterritorial effects of regulations and the complexities of harmonizing national laws to accommodate third-country CRAs and CCPs. The dynamic interplay between global standards and the EU's regulatory environment calls for continuous vigilance and adaptation to maintain financial stability and market integrity.

As we move forward in this study, it is imperative to recognize that the regulation of CRAs and CCPs is a constantly evolving landscape, driven by both international cooperation and domestic considerations. By understanding the particulars of the global regulatory framework and its development in the EU's financial landscape, it is easier to recognize the complexities and opportunities that lie ahead in ensuring financial stability.

CHAPTER V: THE MECHANICS OF CRAS AND CCPS IN EU LAW

This chapter examines the regulatory and supervisory framework governing CRAs and CCPs within the EU. While the primary focus centers on the instruments allowing for third-country CRAs and CCPs in the EU, it also delves into the regulatory approach applied to CRAs and CCPs that are legally established within the EU. This comprehensive analysis is essential as the regulation of both EU-based and third-country CCPs is closely interconnected.

1 Legal Framework of Credit Rating Agencies (CRAs) in the European Union

1.1 Literature Review

The literature on CRAs regulation and supervision in the EU is distinctly divided into two periods: the pre-crisis era and the post-crisis landscape. While both periods have garnered significant scholarly attention, this chapter will specifically concentrate on the post-crisis literature, which examines the regulatory reforms and advancements made in response to the 2008 global financial crisis. The European Parliament and the European Commission have unequivocally emphasized the pivotal role of regulating CRAs in ensuring financial stability and bolstering investor confidence within the EU.[585] As the financial crisis of 2008 exposed the potential risks associated with credit ratings, there has been a growing interest in examining the challenges of regulatory frameworks governing CRAs, both within the EU and from third-country jurisdictions.[586] Hence,

[585] European Commission, 'Note for the Informal ECOFIN Council. A First EU Response to ENRON Related Issues' (2005); European Parliament, Resolution on Role and Methods of Rating Agencies (2003/2081) INI.

[586] Deipenbrock and Andenas (n 97); Thomas MJ Möllers and Charis Niedorf, 'Regulation and Liability of Credit Rating Agencies: A More Efficient European Law?' (2014) 11 European Company and Financial Law Review 333; Moloney, 'Gatekeeper Regulation and the EU' (n 68); Amtenbrink and De Haan (n 95).Charles AE Goodhart, *The Regulatory*

scholars and policymakers alike have acknowledged that effective and transparent regulation of CRAs is essential to maintain a resilient and well-functioning financial system.[587]

Consequently, notable contributions have been made through the CRA Regulation I in 2009 and the subsequent amendments under the CRA Regulations II and III. Research by García-Ruiz, Darbellay and Deipenbrock provides an in-depth analysis of the pros and cons of CRA Regulation I.[588] On the other hand, Wymeersch, Tridimas and Moloney examine the impact of the amendments with CRA Regulation II and III and their provisions on the ESMA's role as supervisor.[589]

Response to the Financial Crisis (Edward Elgar Publishing 2009).Philippe Raimbourg and Federica Salvadè, 'Reforming Rating Agencies' in Raphaël Douady, Clément Goulet and Pierre-Charles Pradier (eds), *Financial Regulation in the EU: From Resilience to Growth* (Palgrave Macmillan 2017).

[587] Committee of European Securities Regulators (CESR) Report on compliance of EU-based credit rating agencies with the 2008 IOSCO Code of Conduct (Ref. CESR/09-417) (n 382); Committee on the Global Financial System (n 381); Lucia Quaglia, 'The Politics of Regulating Credit Rating Agencies in the European Union' (2009) 5; Rousseau (n 49); Darbellay, 'Regulating Ratings, The Credit Rating Agency Oligopoly from a Regulatory Perspective' (n 64). Gudula Deipenbrock, 'After CRA III – Achievements and Challenges from the Legal Perspective' (2014); Ugo Bassi and others, 'Credit Rating Agencies: Implementation of Legislation European Parliament Study (June 2014) PE 518.755' (2014); Miglionico (n 56).

[588] Raquel García-Alcubilla and Javier Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' in Raquel García-Alcubilla and Javier Ruiz-del Pozo (eds), *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (Oxford University Press 2012); Gudula Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (2014) 25 European Business Law Review 207; Darbellay (n 63).

[589] Eddy Wymeersch, 'The Institutional Reforms of the European Financial Supervisory System, an Interim Report' (2010) 01 1; Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making' (n 236); Niamh Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (2) Rules in Action' (2011) 12 European Business Organization Law Review 177; Takis Tridimas, 'Financial Supervision and Agency Power: Reflections on ESMA' in Niamh Nic Shuibhne and Laurence W Gormley (eds), *From Single Market to Economic Union* (Oxford University Press 2012); Andenas and Deipenbrock (n 384); Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).

The provisions concerning third-country CRAs seeking equivalence status in the EU have garnered considerable attention and have become a topic of significant controversy. Ferran, Berger and Badenhoop, among others, have engaged in extensive discussions and analyses, especially in the wake of Brexit, as the UK transitioned into a third country.[590]

The debate surrounding equivalence and endorsement is multifaceted and nuanced. On one hand, proponents argue that granting such status can enhance market access and foster cross-border financial integration. On the other hand, there are also discussions about the need for robust supervision and coordination between the EU and third-country authorities to ensure consistent and effective oversight.

The regulation of EU and non-EU CRAs within the EU law context presents a multifaceted landscape of opportunities and challenges. While EU regulations have significantly improved transparency and accountability in the credit rating industry, ensuring access to third-country CRAs can have certain effects such as an extraterritorial reach of EU law.

This research will provide valuable insights into the complexities surrounding the regulation of CRAs in the EU and set the stage for future research in this critical field.

1.2 Analysis of the regulatory framework of Credit Rating Agencies in the European Union

CRAs in the EU were no exception to the global landscape during the crisis. Consequently, these agencies experienced a comprehensive overhaul in

[590] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241); Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26); Henning Berger and Nikolai Badenhoop, *Financial Services and Brexit: Navigating Towards Future Market Access*, vol 19 (Springer International Publishing 2018); OEberg (n 337); Pierre Schammo, 'Global Central Counterparties' in Iris HY Chiu and Iain G MacNeil (eds), *Research Handbook on Global Capital Markets Law* (Edward Elgar Publishing 2023).

their regulatory and supervisory framework to address their poor performance during the crisis.

Following the Enron's collapse,[591] the EU recognized the significance of CRAs and the international policy implications they raised.[592] In response, during the Oviedo Informal Economic and Financial Affairs Council in April 2002, the European Commission called for a comprehensive policy evaluation across different sectors to assess the need for regulatory intervention in the realm of CRAs.[593]

The EU eventually took measures following the global agreement among G-20 leaders during the April 2009 summit, which recognized the necessity to regulate the operations of CRAs.[594] The European Parliament took a significant step in February 2004 when it adopted a Resolution expressing its perspective on the role and practices of credit rating agencies (CRAs).[595] While recognizing the positive impact of CRAs in financial markets, the Resolution also emphasized certain concerns that required further measures to ensure responsible conduct by CRAs. Hence, it called for an evaluation of the feasibility of establishing a registration system for CRAs within the EU. The European Commission was requested

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[591] CRAs' reputation has been called into question following incidents like Enron and Lehman Brothers, where these agencies assigned high ratings shortly before their collapse. Consequently, CRAs are frequently criticized for their inability to deliver accurate ratings essential for significant investment choices in the market. Their integrity has been a subject of concern in light of these events, as investors and the public question their reliability and effectiveness in providing reliable assessments. See more: Claire A Hill, 'Rating Agencies Behaving Badly: The Case of Enron' (2003) 35 Connecticut Law Review 1145; Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).

[592] Rousseau (n 49).

[593] European Commission, 'Note for the Informal ECOFIN Council. A First EU Response to ENRON Related Issues' (n 585).

[594] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).

[595] European Parliament, 'Report on role and methods of rating agencies (2003/2081(INI))', 29 January 2004.

to provide an assessment of the need for appropriate legislative proposals to address CRAs by 31 July 2005.[596] Consequently, lawmakers within the EU maintained their efforts to establish a new regulatory authority for CRAs in Europe.[597]

The subsequent phase of EU regulation concerning CRAs involved the implementation of a comprehensive legislative response. Following the global financial crisis, there was a widespread acknowledgment that the self-regulatory approach had proven ineffective.[598] Consequently, in 2008, the European Commission proposed the adoption of a regulation specifically targeting CRAs.[599] Eventually, the European Parliament introduced a series of directives and regulations to enforce this proposal. The first legal act was Regulation 1060/2009 (CRA Regulation I) and it established a regulatory framework for CRAs based on the IOSCO Principles.[600] CRA Regulation I established, for the first time, a regulatory framework that was legally binding on CRAs within the EU.[601] The first amendment was implemented through the Regulation 513/2011 (CRA Regulation II) and it granted ESMA the authority to register and supervise CRAs.[602] The second amendment reexamined the initial legislative

[596] Tobias Johansson, 'Regulating Credit Rating Agencies: The Issue of Conflicts of Interest in the Rating of Structured Finance Products' (2012) 12 Journal of Banking Regulation.
[597] Partnoy (n 49).
[598] Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[599] European Commission Proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes (n 569); European Commission, Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies {SEC(2008) 2745} {SEC(2008) 2746}.
[600] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).
[601] Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[602] 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 [2011] OJ L 145/30 (CRA Regulation II) (n 99).

objectives of the CRA Regulation and it was implemented through Regulation (EU) No 462/2013, concentrating on areas that were deemed to have not been adequately addressed.[603] In particular, this Regulation added a civil liability regime for CRAs at European level and provisions relating to the rating of sovereign debt.

In addition to these sector-specific regulations, there are other rules that exert a significant influence on the management of Credit Rating Agencies (CRAs) within the EU. The most important is the Regulation 1095/2010 that established ESMA, a pan-European regulatory authority, to replace CESR.[604]

On the other hand, it is important to note that the EU CRA Regulation does not merely replicate IOSCO's Code in a legislative format.[605] The CRA Regulation institutes a registration system that serves as a fundamental requirement for CRAs to issue ratings intended for regulatory purposes within the EU.[606] In fact, some authors assert that the key element of the Credit Rating Regulation lies in the registration requirement outlined in Article 14, along with the accompanying registration procedure.[607]

Furthermore, the structure of the regulation can be broadly categorized into three areas: (1) conducting business, (2) surveillance, and (3) civil liability of CRAs.[608] While the conduct of business section of the regulation draws inspiration from the IOSCO Principles and Codes, it also aims to

[603] Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on Credit Rating Agencies.
[604] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) (n 562).
[605] Amtenbrink and De Haan (n 95).
[606] Darbellay (n 63).
[607] Möllers and Niedorf (n 586).
[608] Wittenberg (n 208).

address the oligopolistic tendencies within the CRA market by introducing measures to promote competition.[609]

1.2.1 Main Challenges to Regulate CRAs in the EU

1.2.1.1 Conflicts of Interest

CRAs act as intermediaries in the market, mediating between debtors and creditors. Their primary responsibility is to furnish creditors with dependable, unbiased information regarding the creditworthiness of debtors. However, as profit-driven companies, many CRAs possess diverse interests that might lead to conflicts.[610]

The first conflict arises from the collaboration between CRAs and issuers of structured finance products, wherein CRAs are paid to design products that they will subsequently rate.[611] This poses a distinct conflict as the agency receives a separate, often lucrative, fee for this service.[612] By contrast, the second conflict of interest arises from the issuer-pay model, which has been in place since the mid-1970s.[613] Under this model, issuers of securities hire and pay CRAs to rate their own financial products.[614] Consequently, CRAs are no longer independent but have an interest in attracting business from the firms seeking the rating.[615] This business-driven incentive may lead to positive ratings, creating ambiguity in the

[609] Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[610] Hiss and Nagel (n 51).
[611] Langohr and Langohr (n 403).
[612] Hiss and Nagel (n 51).
[613] Coffee Jr (n 78).
[614] White, 'Markets, The Credit Rating Agencies' (n 47).
[615] Securities and Exchange Commission (SEC), Annual Report on Nationally Recognized Statistical Rating Organizations: As Required by Section 6 of the Credit Rating Agency Reform Act of 2006 2008.

ratings. This conflict becomes more pronounced in the field of structured finance where there is a limited number of issuers.[616]

Consequently, the primary focus of most regulatory efforts is addressing these conflicts of interest as they have the potential to compromise the independence and reliability of credit ratings.[617] Proposed solutions often revolve around promoting greater competition between CRAs and increasing transparency in the rating processes. Additional suggestions range from non-regulation, to avoid further recognition of ratings through legal measures,[618] to more drastic ideas like abolishing rating agencies altogether, as proposed by the German Services Union (Vereinte Dienstleistungsgewerkschaft Ver. Di).[619]

1.2.1.2 Competition

According to the relevant Commission's report of 19 October 2016 (Commission 2016 report on Credit rating Market) the rating industry is currently dominated by three 'US-based firms' (S&P, Moody's and Fitch) with a global geographic coverage of all asset classes and a cumulative market share in revenues of approximately 92% in the union.[620]

Consequently, academic researchers have highlighted the limited competition among CRAs as a significant flaw in the industry.[621] Furthermore, feedback from various commentators participating in

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[616] Securities and Exchange Commission (SEC), Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies By the Staff of the Securities and Exchange Commission 2008.
[617] Hiss and Nagel (n 51).
[618] Lynch (n 43).
[619] J Jurczyk, 'Press Release. Rating Agencies: Ver.Di Downgrades Moody's: Ratings Are Only Code Reading' (2010).
[620] European Commission, 'Report from the Commission to the European Parliament and the Council on Alternative Tools to External Credit Ratings the State of the Credit Rating Market, Competition and Governance in the Credit Rating Industry, the State of the Structured Finance Inst' (2016).
[621] Amtenbrink and Heine (n 95); Caliari (n 48); Hiss and Nagel (n 51).

consultations conducted by the Securities and Exchange Commission (SEC) and the European Commission on CRAs commonly mentions the presence of an oligopolistic structure in the market as a factor that might have contributed to the rating industry's malfunctioning.[622] However, competition is a significant concern in US regulation whereas in the EU it has not gained much attention.[623] To address this, US regulation seeks to promote competition among CRAs and improve the quality and objectivity of ratings by completely overhauling the Nationally Recognized Statistical Rating Organization (NRSRO) status and establishing a formal recognition procedure for CRAs.[624] However, there is a potential risk of unintended consequences, such as "ratings shopping," where rated entities seek the most favorable ratings by approaching different CRAs.[625]

1.2.1.3 Transparency and Disclosure of Information

The insufficient disclosure of information concerning the nature and restrictions of ratings and the failure to provide adequate details about critical model assumptions have been an issue to regulate CRAs. Furthermore, some examinations revealed instances where essential rating criteria were not fully disclosed, impeding investors from comprehending the true significance and reliability of the ratings. Furthermore, the clarity of information accompanying the ratings was not consistently satisfactory.[626]

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[622] Raquel García-Alcubilla and Javier Ruiz-del Pozo, 'Financial Crisis : Global Regulatory Reaction' in Raquel García-Alcubilla and Javier Ruiz-del Pozo (eds), *Credit Rating Agencies on the Watch List: Analysis of European Regulation* (Oxford University Press 2013).
[623] Hiss and Nagel (n 51).
[624] Caliari (n 48).
[625] Hiss and Nagel (n 51).
[626] ibid.

More transparency in CRAs is a solution that could improve several aspects of CRAs. For instance, increased transparency in rating methodologies could potentially encourage greater competition among CRAs.[627] However, there is a significant downside to disclosing these methodologies because when a CRA shares its research methodology, competitors may copy it, leading to reduced incentives for innovation and the development of new rating approaches.[628] As a result, CRAs may hesitate to invest in new research methods if the benefits of such investments are immediately shared with rival agencies.

1.2.2 Difference between CRA Regulation I and IOSCO Code 2015

The CRA Regulation, which mandated the registration and EU oversight of CRAs from the United States, did not depend on deference to foreign regulatory oversight.[629] As a result, conflicts arose making it crucial to establish a system for managing these conflicts.[630] Notably, the CRA Regulation also influenced the revised 2015 IOSCO CRA Code of Conduct, creating a loop of influence between European and international standards.[631]

These European influences, characterized by a different balance between private and public interests and a lesser emphasis on disclosure-based regulatory approaches, immediately created discrepancies with the US regulatory approaches, placing the 2015 revisions of the IOSCO CRA Code of Conduct in opposition.[632]

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[627] Piero Cinquegrana, 'The Reform of the Credit Rating Agencies: A Comparative Perspective' (2009); Blaurock (n 48).
[628] Amtenbrink and Heine (n 95).
[629] Miglionico (n 56).
[630] Deslandes, Dias and Magnus (n 550).
[631] Cally Jordan, 'The New Internationalism? IOSCO, International Standards and Capital Markets Regulation' (2018) 189.
[632] ibid.

1.2.3 Timeline Before the Current Regulation 1060/2009

Initially, the EU adopted a self-regulatory approach for credit rating agencies (CRAs), leading to a lack of specific regulations in place.[633] However, based on the findings of various surveys, the EU recognized the need for a comprehensive legal framework to ensure the promotion of independence, quality, and transparency in credit ratings. As a result, the EU shifted towards a more regulated approach to address the challenges identified in the credit rating industry.

The first significant milestone was the European Parliament's Resolution in February 2004, acknowledging the positive role of CRAs in financial markets.[634] However, the resolution also raised concerns about certain issues that required attention to ensure responsible conduct by CRAs in fulfilling their role. Consequently, in response to these concerns, the European Parliament requested the European Commission to conduct a thorough evaluation to determine the necessity of appropriate legislative measures to address the issues surrounding CRAs.[635]

The European Commission sought Committee of European Securities Regulators (CESR today ESMA)' perspective on regulating CRAs' operations in order to provide an answer to the European Parliament.[636] In response, the ESMA recommended against European-level regulation and suggested a self-regulatory system with a monitoring of the degree to which CRAs adhered to the voluntary guidelines outlined in the IOSCO

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[633] Altman and others (n 49).
[634] European Parliament Resolution on Role and Methods of Rating Agencies (2003/2081) INI (n 585).
[635] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).
[636] Committee of European Securities Regulators (CESR), 'Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and the Role of Credit Rating Agencies in Structured Finance' (2005).

Code.[637] Based on the recommendation of the CESR, the European Commission opted for not presenting any new proposals to legislate CRAs, believing current financial services directives adequately addressed the European Parliament's concerns.[638]

As time passed, it became evident that the self-regulation framework adopted in Europe and other regions had inherent limitations, which started to impact the operational practices of CRAs significantly.

In January 2006, the Commission released a Communication within this framework, concluding that existing financial services directives, specifically those encompassed by the Market Abuse Directive and the Capital Requirements Directive, in combination with self-regulation adhering to the IOSCO Code, could sufficiently address the primary concerns surrounding CRAs.[639] Nevertheless, as proposed by CESR, the Communication indicated that the European Commission could contemplate legislative action if it became evident that adherence to EU regulations or the IOSCO Code proved inadequate or if new circumstances arose, such as market failure or significant changes in global CRA regulations.[640] Furthermore, the Commission requested ESMA to oversee compliance with the IOSCO Code and provide annual reports on the matter.

In response to instructions from the European Commission, the CESR (today ESMA) created a voluntary framework for CRAs that wished to participate in order to annually report on their level of adherence to the

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[637] Committee of European Securities Regulators (CESR), 'Technical Advice to the European Commission on Possible Measures Concerning Credit Rating Agencies (CESR/05-139b)' (n 382).
[638] Langohr and Langohr (n 403).
[639] 'Communication by the Commission on Credit Rating Agencies (2006/C 59/02) OJ C 59, 11.3.2006, p.2'.
[640] Tridimas (n 589).

IOSCO Code.[641] Notably, DBRS, Fitch, Moody's, and S&P chose to comply with ESMA's proposal.[642]

CESR issued its initial report to the European Commission in January 2007, determining that CRAs largely adhered to the IOSCO Code but had certain consistent deviations that were selected for further examination. In this regard, in May 2007, the European Commission asked CESR to provide a second report specifically assessing whether the recent developments in financial markets warranted a reconsideration of the decision made in 2006 not to regulate CRAs.[643]

In October 2007, a group of CRAs joined forces to enhance trust in the credit rating process for structured finance securities in an effort to avoid being subjected to regulation.[644] They shared a discussion paper in December 2007 outlining suggestions to enhance independence, quality, and transparency in credit ratings.

CESR provided its advice to the European Commission in May 2008,[645] aligning with the subsequent report from the European Securities Markets Expert Group (ESME) issued in June 2008.[646] The CESR's recommendation involved strengthening the self-regulatory system through the

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[641] Committee of European Securities Regulators (CESR), 'PRESS RELEASE: CESR Monitors Self Regulation by Credit Rating Agencies and Announces a Call for Evidence from Market Participants on the Application of the IOSCO Code of Conduct' (2006).
[642] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61).
[643] Committee of European Securities Regulators (CESR), 'Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and the Role of Credit Rating Agencies in Structured Finance' (2006).
[644] Amtenbrink and De Haan (n 95).
[645] Committee of European Securities Regulators (CESR), Second Report to the European Commission on the compliance of credit rating agencies with the IOSCO Code and the role of credit rating agencies in structured finance (Ref. CESR/08-277).
[646] Committee of European Securities Regulators (CESR), 'CESR's Second Report to the European Commission on the Compliance of Credit Rating Agencies with the IOSCO Code and the Role of Credit Rating Agencies in Structured Finance (May 2008) CESR/08-277' (n 49).

establishment of an international body comprised of market participants designated by regulators.[647] This body would have a dual role: developing a set of conduct rules in line with those outlined in the IOSCO Code and overseeing compliance with them.[648] Therefore, the CESR suggested that the creation of this body should be coordinated with regulators from other international markets and if coordination was not feasible, it could be implemented within the European Union.[649]

On the other hand, on 8 July 2008, EU finance ministers reached a consensus to establish European regulations that would ensure the supervision of CRAs within the EU through a registration process. The Council requested the Commission to formulate concrete proposals for implementing a European mechanism to register credit rating agencies.

Consequently, the European Commission made the decision to propose the implementation of legislation governing CRAs within the European Union. Furthermore, The Council requested that the Commission put forth precise suggestions for the establishment of a European system for the registration of credit rating agencies.[650] As a result, the European Commission released a consultation paper on 31 July 2008, presenting a proposal for the adoption of a comprehensive set of regulations outlining the essential criteria that CRAs would be required to comply with for their authorization and operation of rating activities within the EU.[651] Finally,

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[647] Committee of European Securities Regulators (CESR) Second Report to the European Commission on the compliance of credit rating agencies with the IOSCO Code and the role of credit rating agencies in structured finance (Ref. CESR/08-277) (n 645).
[648] Amtenbrink and Heine (n 95).
[649] Charles AE Goodhart, 'How, If at All, Should Credit Ratings Agencies (CRAs) Be Regulated? (April 2009)' Initiative for Policy Dialogue Working Paper Series.
[650] Utzig (n 42).
[651] European Commission Consultation document on a proposal for a Directive/Regulation of the European Parliament and of the Council on Credit Rating Agencies (n 382).

on 12 November 2008, the European Commission officially issued its proposal for the regulation of CRAs.[652]

Then, the CESR released its third report on CRAs' adherence to the IOSCO Code in March 2009, as per the European Commission's request.[653] This report delved into a more detailed evaluation of the progress made by CRAs based in the EU in implementing the updated IOSCO Code.[654] ESMA's overall assessment of the global CRAs' codes of conduct, including S&P, Moody's, Fitch, DBRS, and AM Best, indicated that they generally aligned with the IOSCO Code.[655] Regarding the other 19 EU-based CRAs examined, CESR found that approximately one-third had not adopted any code of conduct.[656]

After the Consultation Paper, the European Commission published the proposal and the Regulation 1060 (CRA Regulation I) was officially published in the European Official Journal on 17 November 2009.

1.2.4 Regulation 1060/2009 (CRA Regulation I)

The CRA Regulation I focused on credit rating issuance and the organization, and practices of CRAs.[657] Its main objectives were to safeguard the stability of financial markets and investors, ensure credit rating quality, address conflicts of interest, promote transparency in credit

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[652] European Commission Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies {SEC(2008) 2745} {SEC(2008) 2746} (n 599).
[653] Committee of European Securities Regulators (CESR) Report on compliance of EU-based credit rating agencies with the 2008 IOSCO Code of Conduct (Ref. CESR/09-417) (n 382).
[654] ibid.
[655] Caliari (n 48).
[656] Committee of European Securities Regulators (CESR) Report on compliance of EU-based credit rating agencies with the 2008 IOSCO Code of Conduct (Ref. CESR/09-417) (n 382).
[657] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

rating activities, and encourage competition in the CRA market.[658] Additionally, the regulation ensures that credit ratings utilized in the EU are unbiased, objective, and sufficiently reliable.[659]

The CRA Regulation I was driven by the turmoil of 2008, signifying a profound shift in the Union's approach to regulating CRAs.[660] The legislative process of the CRA Regulation, along with its subsequent reforms, became part of the mid-2009 reform agenda.[661] This agenda aimed for longer-term solutions after having dealt with crisis-driven emergency measures under considerable time constraints.[662] The reason for regarding the CRA Regulation as a longer-term reform act can be attributed to the history of the preceding self-regulatory regime for CRAs at the Union level and the lack of a binding instrument.

Furthermore, the CRA Regulation I not only surpassed a mere incorporation of IOSCO's Code of Conduct through legislation but also implemented a robust registration system as the fundamental prerequisite for CRAs to issue ratings designated for regulatory purposes within the EU.[663] The regulation's framework can be categorized into three main areas: (1) the conduct of business, (2) surveillance, and (3) civil liability of CRAs.[664] The conduct of business section draws inspiration from the IOSCO Principles and Codes, while also aiming to address the

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[658] Deipenbrock and Andenas (n 97).
[659] Quaglia, 'The Politics of Regulating Credit Rating Agencies in the European Union' (n 587).
[660] Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[661] Eilís Ferran, *The Legacy Effects of the Financial Crisis on Regulatory Design in the EU* (2009).
[662] ibid.
[663] Quaglia, 'Financial Regulation and Supervision in the European Union after the Crisis' (n 2).
[664] Wittenberg (n 208).

prevalence of oligopoly in the CRA market by implementing measures to encourage competition.[665]

This dissertation comprehensively explores the regulatory framework governing CRAs, recognizing their role as providers of ratings for regulatory purposes.

1.2.4.1 Amendment 1: Regulation 513/2011 (CRA Regulation II)

When ESMA (European Securities Market Authority) was officially established to replace the CESR at the end of 2010 through the Regulation 1095/2010,[666] amendments were introduced to CRA Regulation I to assign ESMA as the European authority responsible for CRAs.[667] This new role encompassed registration, approval, standard setting, ongoing supervision, and enforcement. This updated framework replaced the fragmented coordinated approach previously carried out by national supervisors in a college-like structure.[668] Consequently, Regulation (EU) No 513/2011,[669] also known as the CRA II Regulation, was implemented to facilitate this reorganization and grant ESMA exclusive authority for the supervision of CRAs registered within the European Union (EU).

Both CRA Regulation I and II imposed a procedural rulebook on EU's CRAs, introducing conflict-of-interest and quality assurance rules overseen by ESMA. Nevertheless, it could be argued that neither

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[665] Raimbourg and Salvadè (n 586).
[666] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 20 (n 562).
[667] Eddy Wymeersch, 'The European Financial Supervisory Authorities or ESAs' in Eddy Wymeersch, Klaus J Hopt and Guido Ferrarini (eds), *Financial regulation and supervision. A post-crisis analysis* (Oxford University Press 2012).
[668] Chiu (n 223).
[669] 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 [2011] OJ L 145/30 (CRA Regulation II) (n 99).

Regulation effectively tackled the core systemic risks associated with CRAs, stemming from their integration into the regulatory system, the market's heavy reliance on ratings to assess risk and the resulting pro-cyclical effects, along with the limited liability risk and oligopolistic structure of the CRA market, which hinders market discipline.

The EU started addressing the challenging market structure questions essential for effective reform only through the CRA Regulation III reforms in 2013.

1.2.4.2 Amendment 2: Regulation 462/2013 (CRA Regulation III)

After a span of two years, the EU legislator made the second amendment to the CRA I Regulation through Regulation (EU) No 462/2013,[670] commonly known as the CRA III Regulation, which came into force in June 2013. The Commission's Impact Assessment conducted by the identified several ongoing weaknesses in the CRA market that had not been resolved by previous reforms.[671]

A comprehensive and proactive proposal was presented in November 2011, and after challenging negotiations, it was accepted by the Parliament and Council in December 2012.[672] This proposal, known as the

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670 Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on Credit Rating Agencies (n 603).

671 European Commission, 'Commission Staff Working Document Paper. Impact Assessment Accompanying the Document Proposal for a Regulation Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies and a Proposal for a Directive Amending Directive 2009/65/EC on coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers' (n 382).

672 European Commission, Proposal for a regulation of the European Parliament and of the council amending Regulation (EC) No 1060/2009 on credit rating agencies. 15.11.2011 COM(2011) 747 final; Committee on Economic and Monetary Affairs. Rapporteur: Leonardo Domenici, Report on the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies. The Domenici Report. 2011.

CRA Regulation III, was accompanied by a Proposal for a Directive to reduce reliance on ratings in the 2009 Undertakings for Collective Investment in Transferable Securities (UCITS) and 2011 AIFMD regimes.[673]

The main elements of the CRA Regulation III reform encompassed several aspects: first, an expanded scope of the 2009/2011 regime to encompass rating outlooks and other factors; second, a variety of measures aimed at addressing the issue of ratings over-reliance, both in regulation and by the market; third, a set of additional conflict-of-interest rules devised to tackle risks associated with CRA ownership; fourth, an assortment of regulations governing ratings methodologies, aimed at improving the methodology change process; fifth, requirements to promote competition in the CRA market, including the introduction of CRA rotation requirements specifically for structured-finance ratings; sixth, new requirements for sovereign debt ratings, focused on aspects such as timing of release, accompanying disclosures, and rating review; seventh, a supplementary set of rules for structured-finance ratings, which include a demand for double ratings and disclosure obligations for issuers; eighth, a bolstered public disclosure mechanism through a newly established European Ratings Platform supported by ESMA; and finally, the introduction of a new civil liability regime.

Considering the significant amount of legislative activity that has taken place thus far, it is likely that additional amendments can be anticipated

[673] European Commission, Proposal for a Directive to reduce reliance on ratings in the 2009 Undertakings for Collective Investment in Transferable Securities (UCITS) and 2011 AIFMD regimes, COM (2021) 721 final, 25 November 2021.

in the coming years. In fact, the ESMA has already expressed that a new amendment is necessary.[674]

The most noteworthy and groundbreaking aspect of the new regulation lies in the introduction of a comprehensive civil liability regime in Article 35. This represents a significant departure from the previous regulatory landscape, as it establishes a framework for holding CRAs accountable for their actions and decisions. Under this regime, CRAs can be held legally responsible for any damages caused to investors or issuers as a result of inaccurate or misleading ratings.

Liability under the new regulation is dependent on a breach of any of the obligations outlined in Annex III to CRA Regulation I, coupled with a discernible impact on the credit rating.[675] The list of duties was expanded in Annex III and it encompasses various aspects, including instances such as, conflicts of interest arisen due to personal involvement, as defined by the Regulation, or when obligations related to rotation are not fulfilled.[676] In such cases, liability can be established, leading to potential legal consequences for the CRA involved. Additionally, credit rating agencies can be held liable if they fail to adequately ensure that ratings are derived from a comprehensive analysis of all accessible information. The monitoring of methodologies and ratings should be conducted consistently. Liability may also arise if there is a breach of the extensive

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[674] European Securities and Markets Authority (ESMA), 'ESMA Calls for Legislative Changes to Improve Access to and Use of Credit Ratings' (2021) <https://www.esma.europa.eu/press-news/esma-news/esma-calls-legislative-changes-improve-access-and-use-credit-ratings> accessed 28 November 2023.

[675] See more on CRAs liability in: Möllers and Niedorf (n 2); Harry Edwards, 'CRA 3 and the Liability of Rating Agencies: Inconsistent Messages from the Regulation on Credit Rating Agencies in Europe' (2013) 7 Law and Financial Markets Review 186; Brigitte Haar, 'Civil Liability of Credit Rating Agencies – Regulatory All-or-Nothing Approaches between Immunity and Over-Deterrence' (2014) 25 European Business Law Review 315.

[676] Annex III. Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

duties related to disclosure towards ESMA and the public. In essence, credit rating agencies are expected to exercise due diligence and transparency in their operations to avoid potential liability under the new regulations.

1.2.4.3 Current Debates and Proposals for Further Improvements

CRAs remain a subject of ongoing debate for various reasons, and despite the implementation of regulations, the trust lost during the financial crisis has yet to be fully regained.[677] As a result, supervisors like ESMA continue to harbor concerns regarding the regulation of these agencies for several different reasons. In fact, ESMA has issued an Opinion advocating for changes in the current CRAs regulation to address these matters.[678]

The proposed changes touch on various aspects, addressing concerns related to credit ratings research reports, clarification of information which should be disclosed, accuracy of ancillary services, data licences and infringements for the provisions concerning data, ratings access.

These suggested changes aim to bolster investor confidence and protect financial stability, considering the pivotal role that credit ratings play in shaping investment decisions.[679] Despite the existing regulatory framework, there is an acknowledgment that continuous supervision and adaptation are necessary to strengthen the credibility and effectiveness of CRAs in the financial landscape.

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[677] John Ryan, 'The Negative Impact of Credit Rating Agencies and Proposals for Better Regulation' (2012) 1 SWP Working Paper 1.
[678] European Securities and Markets Authority (ESMA), 'OPINION OF THE EUROPEAN SECURITIES AND MARKETS AUTHORITY of 22 September 2021 on Improving Access to and Use of Credit Ratings in the European Union in Accordance with Regulation (EC) No 1060/2009' (n 383).
[679] European Securities and Markets Authority (ESMA), 'ESMA Calls for Legislative Changes to Improve Access to and Use of Credit Ratings' (n 674).

It is important to highlight that the current discussions and proposals surrounding CRAs regulation primarily pertain to CRAs operating within the EU jurisdiction. However, the significance of third-country CRAs should not be underestimated, as they can also exert a substantial impact on investor protections and financial stability. The instruments to allow third-country CRAs in the EU necessitates careful consideration and supervision.

The absence of specific proposals or concerns regarding third-country CRAs could potentially create regulatory gaps and raise questions about the consistency of investor protection measures across the global financial landscape (See Chapter IV). Harmonizing the regulatory approach for both EU-based and third-country CRAs is essential to mitigate potential risks stemming from divergent standards and practices.

Efforts should be directed towards fostering international cooperation and coordination in the regulation of CRAs, as their cross-border activities can significantly affect the EU's financial stability and investor confidence.[680] By actively engaging with third-country regulators and harmonizing regulatory frameworks, the EU can better address the challenges posed by third-country CRAs and ensure a more cohesive and effective global regulatory environment for these critical financial market participants.

1.3 Analysis of the supervisory framework in the European Union

The operational design for the supervision arrangement in CRA Regulation I was problematic; hence, the supervision system was originally predicted as temporary and has been updated over the years.[681] The original system was based on co-ordination between CESR, the home National Competent

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[680] Tietje and Lehmann (n 394).
[681] Moloney, 'Gatekeeper Regulation and the EU' (n 68).

Authorities (NCAs), and a College of Supervisors but it proved difficult to work.[682]

Consequently, to establish a robust and efficient supervisory framework and ensure consistent implementation of the CRA Regulation, it mandated the registration and ongoing supervision of CRAs, assigning exclusive responsibility to ESMA for this task.[683] ESMA is the single EU supervisor for credit rating agencies, responsible for CRA registration, supervision, and the enforcement of the CRA Regulation I. The regulation also includes provisions for CRAs to report their credit rating actions. As a result, ESMA has built up an extensive dataset on credit ratings and related actions. In addition to facilitating market transparency and the monitoring of CRAs, this provides a rich dataset on the state of credit rating markets in the EU and on the extent of and the trends in credit risk.

It is important to note that ESMA's oversight does not extend to users of ratings, such as financial institutions.[684] The responsibility for overseeing such users lies with the sectoral competent authorities of the respective Member States.[685]

The European legislator argues for the "direct supervisor approach," as highlighted in Recital (35) of the CRA II Regulation. It emphasizes that

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[682] García-Alcubilla and Ruiz-del Pozo, 'Analysis of the EU Credit Rating Agencies Regulation' (n 61). The colleges of supervisors would include all authorities where the agency had a registered office (such as a subsidiary). Furthermore, competent authorities in countries where the agency had a branch or its ratings were widely used or had a significant impact could choose to join the college voluntarily. In case of disagreements among college members on a decision, the CRA Regulation I mandated ESMA's intervention.

[683] Eilís Ferran, 'Understanding the New Institutional Architecture of EU Financial Market Supervision' in Eddy Wymeersch, Klaus J Hopt and Guido Ferrarini (eds), *Financial Regulation and Supervision: A post-crisis analysis*, vol 15 (Online, Oxford University Press 2015).

[684] Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making' (n 236).

[685] Wymeersch, 'The European Financial Supervisory Authorities or ESAs' (n 667).

establishing a robust and streamlined supervisory framework for CRAs in the EU is more effectively accomplished at the union level, given the pan-union structure and wide-reaching impact of credit rating activities to be overseen.[686] The first essential institutional requirement to grant ESMA direct supervisory powers in specific areas of the European financial markets is met by conferring legal status on ESMA according to Article 5 of the ESMA regulation.[687]

Additionally, a functional sectoral interconnection among the ESAs and equally appropriate interconnection between ESMA and the relevant NCAs and the European Systemic Risk Board (ESRB) are necessary.[688] Although certain supervisory tasks can be delegated to NCAs, ESMA remains the predominant decision-making body. For instance, NCAs may request that ESMA suspend the use of ratings for regulatory purposes in exceptional situations, but ESMA is not obliged to comply with these requests. With a wide collection of direct supervisory powers at its disposal, ESMA is fully equipped to fulfill its role, including conducting investigations and on-site inspections.[689] In terms of organization, the interconnectedness of the ESAs is primarily demonstrated through the Joint Committee of the ESAs, the composition of ESMA's Board of Supervisors as its central decision-making entity, and the board of appeal, which serves as a joint body for the ESAs.[690]

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[686] Deipenbrock, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies-Some Critical Observations in a Broader Context' (n 1).

[687] Elizabeth Howell, 'The Evolution of ESMA and Direct Supervision: Are There Implications for EU Supervisory Governance?' (2017) 54 Common Market Law Review 1027.

[688] Simoncini (n 565).The European System of Financial Supervisors (ESFS) took effect on January 1, 2011 and was designed to integrate financial supervision across both national and EU levels. ESFS comprises the supervisory bodies of EU Member States and four additional entities: ESMA, EBA, EIOPA, and ESRB.

[689] Payne (n 564).

[690] Schammo (n 563).

Consequently, the responsibility for the day-to-day supervision and enforcement of CRAs has shifted from Member States to ESMA. Additionally, ESMA possesses enforcement capabilities, and when breaches are identified, it has the discretion to impose various monetary and non-monetary penalties, although these enforcement measures are infrequently used.[691]

In addition to ESMA's connections with other ESAs, competent authorities of Member States, and supervisory authorities of third countries, its relationship with the political institutions of the union is significant. In this regard, the de Larosière report initially mandated the ESFs to maintain independence from, yet be held accountable to, the political authorities.[692] Accountability and independence emerged as crucial aspects of the ESAs' institutional structure, although not explicitly defined through specific concepts and categories.[693] Instead, they were established as guiding principles in the regulations that created the ESAs and outlined their areas of operation. These two frameworks have been extensively debated in the context of financial regulatory bodies.[694] Striking the right balance between these two systems is especially crucial for ESMA's role as the direct supervisor of CRAs in the European Union.

CRAs are also subject to the comprehensive prudential regulations that govern banks and investment firms more precisely those regarding the calculation of capital charges.[695] Specifically, they are considered "external credit assessment institutions" and are subjected to prudential

[691] European Securities and Markets Authority (ESMA), 'Guidelines on the Scope of the CRA Regulation' (n 383).
[692] de Larosière and others (n 201).
[693] Schammo (n 563).
[694] See more Pablo Iglesias-Rodríguez, *The Accountability of Financial Regulators* (Wolters Kluwer 2014).
[695] Raimbourg and Salvadè (n 586).

framework requirements outlined in the 2013 Capital Requirements Directive IV (CRD IV) and the Capital Requirements Regulation (CRR).[696]

On the other hand, rating-directed regulation also necessitates effective cooperation between ESMA and third countries to ensure the global impact of CRAs is appropriately addressed.[697] Since CRAs operate across international borders and provide ratings for entities and financial instruments worldwide, it is essential for ESMA to collaborate with regulatory authorities from non-EU countries. CRA Regulation I established guidelines regarding the exchange and disclosure of information between ESMA and supervisory authorities from third countries.

1.4 Scope of the supervision of Credit Rating Agencies in EU law

Credit Rating Agencies in the EU are registered and supervised by the ESMA due to a centralization of competences.[698] The national securities supervisors of each Member State are all part of the ESMA.[699] Prior to the implementation of Regulation 513/2011 (CRA II Regulation), the determining factor for assigning the competent authority responsible for registering and overseeing a rating agency (either parent or subsidiary) within the European Union (EU) was based on the geographical location of its registered office.[700]

In this regard, Article 3(1)(b) of the Regulation 1060/2009 (CRA I Regulation) defines a credit rating agency as a legal entity that issues

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[696] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (n 567).

[697] Deipenbrock, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies-Some Critical Observations in a Broader Context' (n 1).

[698] Darbellay (n 8), 70.

[699] Howell (n 687).

[700] Carvajal (n 224).

credit ratings in a professional capacity. According to the Regulation, CRAs are considered individual entities, and each subsidiary established by third-country CRAs within the EU is regarded as a separate credit rating agency. Consequently, all the requirements specified in the Regulation must be met by each subsidiary entity within the group. When the CRA is entirely established abroad different rules apply (see Chapter VI).

It is important to note that for registration purposes, the concept of a group does not include CRAs established in third countries. This contrasts with the approach of US rules, which allow registration to include separate legal entities established in different countries.[701] However, CRA Regulation I specifies that for the purpose of endorsement, a group of CRAs includes CRAs established in third countries.

2 Legal Framework of Central Counterparties (CCP) in the European Union

2.1 Literature Review

The regulation of CCPs in the European Union EU has been a topic of significant interest and research in the aftermath of the global financial crisis of 2008.[702] Scholars have extensively explored the role of CCPs in the financial system and the regulatory measures implemented to enhance their safety and stability.[703]

This is because of the success of CCPs in reducing counterparty risks within the financial markets. Hence, international standard setters and national regulators shifted their focus towards these entities in the post-

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[701] Hiss and Nagel (n 51).

[702] Borio, Farag and Tarashev (n 405); Nijs (n 103); Nabilou and Asimakopoulos (n 104).Binder (n 172).

[703] Priem (n 175); Heikki Marjosola, 'Missing Pieces in the Patchwork of EU Financial Stability Regime?The Case of Central Counterparties' (2015) 52 Common Market Law Review 1491; Ferrarini and Saguato (n 120).

trade processes.[704] They introduced regulations that mandated higher levels of CCP clearing, especially for specific classes of financial instruments like standardized OTC derivatives,[705] which are the focus of the CCP's regulation studied in this dissertation. In both the USA and the EU, laws and regulations were enacted to require the mandatory central clearing of an expanding range of financial contracts.[706] The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 in the USA, and the EMIR in the EU, established the framework for such mandatory clearing of standardized derivatives.[707]

The EMIR has been a cornerstone in the regulation of CCPs in the EU. Scholars such as Dell'Erba, Nabilou and Asimakopoulos have studied the impact of EMIR on the clearing landscape and its effectiveness in mitigating systemic risk.[708] Among other requirements, EMIR introduced mandatory clearing obligations for certain OTC derivatives, leading to the concentration of a substantial amount of risk in CCPs.[709] Studies by

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[704] Heath and others (n 24); Van R Johnston, 'The Struggle for Optimal Financial Regulation and Governance' (2013) 37 Public Performance and Management Review 222; Domanski, Gambacorta and Picillo (n 135).

[705] Baker (n 7); Wendt (n 107); Glass (n 106); Weber 'Central Counterparties in the OTC Derivatives Market from the Perspective of the Legal Theory of Finance, Financial Market Stability and the Public Good' (n 112); Braithwaite (n 45); Mark Hsiao, 'Regulation of OTC Derivatives: The CCPs Role and the EMIR' in Iris HY Chiu and Iain G MacNeil (eds), *Research Handbook on Shadow Banking: Legal and Regulatory Aspects* (Edward Elgar Publishing 2018); Francesco Pennesi, 'The Equivalence Framework for Central Counterparties: EU Regulation and Supervision', *Equivalence in Financial Services* (2022).

[706] Levon Garslian, 'Towards a Universal Model Regulatory Framework for Derivatives : Post-Crisis Conclusions from the United States and the EU' (2016) 37 University of Pennsylvania Journal of International Law 941.

[707] Newman and Posner (n 390); Heath P Tarbert, 'The Enduring Legacy of the Dodd-Frank Act's Derivatives Reforms' (2020) 6 Journal of Financial Regulation 159; Dell'Erba (n 230).Tessa White, 'From the Group of Twenty to the Group of Two: The Need for Harmonizing Derivatives Regulation between the United States and the European Union' (2015) 78 Law and Contemporary Problems 301.

[708] Dell'Erba (n 230); Nabilou and Asimakopoulos (n 104).

[709] Szpringer and Szpringer (n 105); Singh (n 163); Weber 'Central Counterparties in the OTC Derivatives Market from the Perspective of the Legal Theory of Finance, Financial Market Stability and the Public Good'(n 112); Braithwaite and Murphy (n 123).

Lannoo and Heath et al. highlighted that this concentration could potentially create new forms of systemic risk.[710] In this regard, the European Commission put forth two proposals on December 7, 2022, aimed at modifying EU legislation concerning derivative markets. The primary objective of these proposals is to decrease the excessive and concentrated exposure of EU financial institutions to third-country CCPs.[711]

On the other hand, the exclusive supervision of CCPs by the ESMA represents a notable shift in the regulatory landscape at the EU level. While this approach centralizes oversight, it has not been without its critics. One of the main concerns raised is the potential concentration of power within ESMA, as it becomes the sole authority responsible for overseeing these critical financial services. Scholars like Canini have examined ESMA's supervisory framework and argue that the ongoing absence of loss mutualization continue to impede the progress towards establishing a unified approach to EU-CCP supervision.[712]

Moreover, the international dimension of CCP regulation has been explored by Pennesi, Moloney and Okonjo, investigating how third-country CCPs can access the EU market through equivalence.[713] Weinstein

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[710] Karel Lannoo and Apostolos Thomadakis, 'Setting EU CCP Policy – Much More than Meets the Eye' [2021] Revue-Banque; Heath and others (n 24).

[711] European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 as regards measures to mitigate excessive exposures to third-country central counterparties and improve the efficiency of Union clearing markets, COM/2022/697 final, 7 December 2022; European Commission, Proposal for a Directive of the European Parliament and of the Council amending Directives 2009/65/EU, 2013/36/EU and (EU) 2019/2034 as regards the treatment of concentration risk towards central counterparties and the counterparty risk on centrally cleared derivative transactions, COM/2022/698 final, COM(2022) 698 final.

[712] Canini (n 107).

[713] Pennesi, 'The Equivalence Framework for Central Counterparties: EU Regulation and Supervision' (n 705); Niamh Moloney, 'Brexit and financial services: (yet)another re-ordering of institutional governance for the EU financial system?' (2018) 55 Common

has explored the consequences of EMIR 2.2 in the context of Brexit,[714] and the potential extraterritorial effects have been analyzed by Löber, shedding light on the challenges in coordinating cross-border regulations.[715]

The literature on the regulation of CCPs in the EU reveals a complex and evolving landscape, with EMIR and ESMA playing critical roles in enhancing stability while addressing the challenges posed by cross-border operations and systemic risk. Ongoing research continues to explore the efficacy of these regulatory measures and their impact on the broader financial system.

2.2 Analysis of the regulatory framework of CCPs in the European Union

Before the financial crisis, the OTC derivatives markets in the EU operated with minimal regulation.[716] Transactions involving OTC derivatives were conducted directly between parties on a bilateral basis, taking place outside of regulated trading venues, and were not subject to formal clearing obligations.[717] However, the turmoil experienced in the derivatives markets during the financial crisis prompted a reform agenda that was initiated by the G20.[718] Over the subsequent years, significant changes occurred in the EU financial markets that brought about a transformation in the regulatory landscape for derivatives and reshaped

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Market Law Review 175; Okonjo (n 374). See more on extraterritoriality: Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (n 108); Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21); Yesha Yadav and Dermot Turing, 'The Extraterritorial Regulation of Clearinghouses' (2016) 2 Journal of Financial Regulation 21.

[714] Weinstein (n 27).

[715] Löber (n 28).

[716] Heath and others (n 24).

[717] Karel Lannoo, 'The Road Ahead after de Larosière' (2009) 195.

[718] Ron Berndsen, 'Fundamental Questions on Central Counterparties: A Review of the Literature' (2021) 41 Journal of Futures Markets 2009.

the CCP industry.[719] The first crucial development involved the implementation of requirements mandating derivatives to be traded on organized exchanges. This move to repatriate the trading of standardized derivatives from the OTC markets to organized trading venues was agreed upon during the Pittsburgh G20 summit in September 2009 and later integrated into the EU's regulatory framework under the 2014 MiFID II/MiFIR framework.[720] The main objective of this shift was to enhance the robustness and transparency of derivatives trading, as well as to bolster regulatory oversight, operational efficiency, and risk management.[721]

The second significant development was the introduction of the requirement for CCP clearing. Starting from June 2016, EMIR mandated the central clearing of specific standardized OTC derivatives in Europe.[722] This move aimed to address counterparty credit risk and promote financial stability by ensuring that certain OTC derivatives were cleared through central counterparties, thus reducing systemic risks and enhancing the resilience of the financial system.[723]

2.2.1 Main challenges to regulate CCPs in the EU

2.2.1.1 Counterparty Credit Risk

At the heart of derivatives lies risk management. Essentially, derivatives are contracts that facilitate the transfer of risk associated with an underlying asset or a group of assets between parties.[724] This risk in

[719] Lucia Quaglia, 'The EU and Global Securities Markets Regulation', *The European Union and Global Financial Regulation* (2014).
[720] Ferrarini and Saguato (n 119).
[721] European Securities and Markets Authority (ESMA), 'Clearing Obligation and Risk Mitigation Tecniques under EMIR' (n 34).
[722] Hsiao (n 705).
[723] Nabilou and Asimakopoulos (n 104).
[724] Wendt (n 107).

particular arises when the counterparty is susceptible to fail to fulfill its obligations, leaving the other party exposed to a risk that it believed it had transferred.[725] This non-performance is legally binding under the contract and can only be excused when the counterparty is financially incapable of fulfilling its obligations, i.e., when it is insolvent.[726] Consequently, this risk of non-performance in the context of derivatives is commonly known as "counterparty credit risk" the chance that the contracting party is effectively out of business and therefore unable to carry out its obligations under the contract.[727] This risk is particularly difficult to regulate because the derivatives traded in CCPs can be highly complex, making it difficult to accurately assess and quantify counterparty credit risk.[728]

2.2.1.2 Systemic Risk

Systemic risk pertains to the interconnectedness and interdependencies among various participants in the financial market, leading to a situation where a substantial loss that initially affects only a few participants can propagate and pose a threat to the entire financial system.[729] In the realm of CCPs, systemic risk is caused because of counterparty risk and it propagates due to the interconnected nature of derivatives transactions.[730] This is because when a major counterparty experiences a failure, the resulting losses spread across the financial system as other

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[725] Board of the International Organization of Securities Commissions (IOSCO) and Committee on Payments and Market Infrastructures (CPMI) (n 44).
[726] Sean J Griffith, 'Governing Systemic Risk: Towards a Governance Structure for Derivatives Clearinghouses' (2012) 61 Emory Law Journal 1153.
[727] Erik Banks, *The Credit Risk of Complex Derivatives* (2004).
[728] Charles K Whitehead, 'Destructive Coordination' (2011) 96 Cornell Law Review 323.
[729] See more in Chapter II, Section 3.1.
[730] Whitehead (n 728).

institutions discover that they are left with unprotected positions precisely when they require protection the most.[731]

The regulation of systemic risk poses a formidable challenge, not only for CCPs but also for all financial services that have come under regulation since the crisis.[732] This complexity arises from the need to address a wide range of potential market failures, which is a daunting task in reality.[733] Consequently, regulators remain concerned about the possibility of future crises, as it is extremely challenging to design regulations that can effectively cover all possible failure scenarios.[734] Despite the efforts to enhance regulatory frameworks, the ever-evolving nature of financial markets and the interconnectedness of various actors make it difficult to provide complete safeguards against all risks. As a result, a continuous review and adaptation of regulatory measures are essential to mitigate systemic risk and promote financial stability in a dynamic global landscape.[735]

2.2.2 Timeline before the current Regulation 648/2012

The regulatory authority of the EU in securities markets was relatively limited until the late 1990s, primarily due to divergent preferences among the major member states, often driven by protectionist motives.[736] However, the situation underwent significant improvement with the implementation of the Lamfalussy reform and the adoption of four directives known as the "Lamfalussy Directives," following the Financial

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[731] Steven L Schwarcz, 'Systemic Risk' (2008) 97 Georgetown Law Journal 193.
[732] Griffith (n 726); Borio (n 218).
[733] Schwarcz, 'Systemic Risk' (n 731).
[734] Steven L Schwarcz, 'Systematic Regulation of Systemic Risk' (2019) 2019 Wisconsin Law Review 1.
[735] ibid.
[736] Tison (n 544).

Services Action Plan (FSAP).[737] Despite these advancements, certain entities or activities within securities markets remained unregulated until the onset of the financial crisis. This was largely due to disagreements among member states, which had different interests at stake, and the less proactive approach taken by the initial Barroso Commission.

Starting from 2001, the Committee of Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (IOSCO) increased their attention towards market infrastructures by giving recommendations to CCPs and Central Securities Depositories (CSDs).[738]

During November 2004, the CPSS and Technical Committee of IOSCO released 15 Recommendations for CCPs, which covered various types of risks encountered by CCPs, along with a methodology for evaluating a CCP's adherence to each recommendation.[739] At the same time, the European Commission presented a Communication with actions to enhance Clearing and Settlement arrangements in the EU.[740]As a response, the European Association of Counterparty Clearing Houses (EACCH) put forward a functional approach towards clearing houses, meaning it concentrates on the functions performed by clearing houses to

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[737] Luca Enriques and Matteo Gatti, 'Is There a Uniform EU Securities Law After the Financial Services Action Plan?' (2008) 14 Stanford Journal of Law, Business and Finance 43.

[738] Committee on Payment and Settlement Systems (CPSS), 'Core Principles for Systemically Important Payment Systems' (2001); Committee on Payment and Settlement Systems and International Organization of Securities Commissions IOSCO. Technical Committee, 'Recommendations for Securities Settlement Systems' (2001).

[739] Committee on Payment and Settlement Systems (CPSS) and Technical Comittee of International Organization of Securities Commissions (IOSCO) (n 124).

[740] European Commission, Communication from the Commission to the Council and the European Parliament. Clearing and Settlement in the European Union – The way forward. COM(2004) 312 final.

establish a definition.[741] This approach was applied not only to clearing houses as a whole but also to individual activities such as "clearing," "settlement," and "custody." Nevertheless, no regulation was introduced at that time. Hence, for a long period CCP regulation primarily occurred at the national level, where national legislatures enacted laws that are enforced by national regulatory authorities.[742]

However, from October 2008 onwards, the European Commission services engaged in extensive consultations with stakeholders to identify the most suitable policy response to the crisis.[743] This process involved numerous one-on-one and group discussions, two public consultations, and a conference to gather input and feedback.[744]

It was not until the year 2012 that EMIR was finally introduced, marking a significant milestone in the regulation of financial markets.[745] The authorization process follows the 2012 CPSS-IOSCO Principles for Financial Market Infrastructure,[746] but it goes beyond these principles, incorporating more comprehensive and detailed measures. Additionally, the EU-specific risks are taken into account, particularly concerning cross-border supervision.

[741] European Association of Counterparty Clearing Houses (EACCH), 'Functional Definition of a Central Counterparty Clearing House (CCP)' (2004).
[742] Lewis (n 117).
[743] Borio, Farag and Tarashev (n 405).
[744] European Commission, Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories. COM(2010) 484 final, 15 September 2010.
[745] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, OJ [2012] L 201/1, 27 July 2012.
[746] Bank for International Settlements, Technical Comittee of International Organization of Securities Commissions (IOSCO) and Committee on Payment and Settlement Systems (CPSS) (n 102).

2.2.3 Sector Specific Regulation: Regulation 648/2012 European Markets Infrastructure Regulation (EMIR)

EMIR, which became effective on 16 August 2012, was implemented to enhance the transparency, and minimize risks in the OTC derivatives markets.[747] It was introduced in response to the 2008 global financial crisis, which highlighted the need for greater oversight and regulation of the derivatives market.[748]

To accomplish its objectives, EMIR mandated the clearing obligation for OTC derivatives meeting specific criteria and also imposed risk mitigation techniques for those derivatives not centrally cleared.[749] Moreover, EMIR required the reporting of all derivative transactions to trade repositories (TRs) and sets forth organizational conduct of business and prudential standards for both TRs and CCPs. Its main objectives also included reporting requirements for parties to derivative contracts, and capital and margin requirements.

2.2.4 Amendment 1: Regulation 2019/834 (EMIR Refit, EMIR II or EMIR 2.1)

This amendment introduced numerous changes to improve the regulatory load of EMIR on derivatives counterparties[750]Significant changes were implemented, with the following being the most notorious: the expansion of the definition of "Financial Counterparty" (FC). This now includes Alternative Investment Funds (AIFs) based in the EU, even if managed by a non-EU entity, as well as central securities depositaries. The amendment also implemented clearing thresholds for FCs and Non

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[747] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012.

[748] Braithwaite (n 45).

[749] Busch and van Rijn (n 583).

[750] Regulation (EU) 834/2019 of 20 May 2019 amending Regulation (EU) No 648/ 2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleare.

Financial Counterparties (NFCs). Moreover, it also established that only contracts entered into after the clearing obligation took effect are required to be cleared under EMIR Refit. It also streamlined reporting requirements from NFC and FC and provided for (i) reconciliation of trade data between TRs, and (ii) access by non-EU regulators to EU TR data.

EMIR Refit also introduced a requirement for clearing members and clients offering clearing services (directly or indirectly) to provide these services under commercially fair, reasonable, non-discriminatory, and transparent (FRANDT) terms. Furthermore, it gave a power of suspension to ESMA which can request the European Commission to suspend a clearing obligation.

On the other hand, EMIR Refit also made changes to Article 39 of EMIR, stipulating that national insolvency laws in Member States should allow for the separate application of assets belonging to defaulting members and assets held in client clearing accounts.

While EMIR Refit aimed to streamline and reduce the burden of EMIR on derivatives counterparties, it didn't go far enough in addressing the complexities and costs associated with compliance. Hence, it could be stated that despite the amendments, EMIR remains a complex and burdensome regulatory framework for market participants, especially smaller entities that may lack the resources to fully navigate its requirements.

2.2.5 Amendment 2: Regulation 2019/2099 (EMIR 2.2)

The primary modification in 2019 pertained to the supervision of CCPs through EMIR 2.2.[751] This led to a significant enhancement of the colleges' authority, requiring them to provide their input on matters such as qualified shareholdings and approvals of significant outsourcing agreements related to risk management activities.[752] The adjustments aimed to strengthen the oversight process and ensure a more comprehensive and effective regulatory framework for CCPs.

In response to Brexit and the distribution of regulatory powers between ESMA and national regulatory authorities in the EU, the European Parliament made revisions to EMIR.[753] These changes introduced a new tiered approach for the recognition of third-country CCPs. In November 2016, the EMIR General Report was published, which concluded that fundamental changes to the core requirements of EMIR were not necessary.[754] However, the report emphasized that any changes aimed at enhancing transparency and mitigating systemic risks in derivatives markets should take into account international principles to ensure the efficient functioning of global markets.[755] After the publication of the EMIR General Report, the European Commission proposed a new supervisory approach for CCPs in June 2017 under EMIR 2.2.[756] This approach would

[751] Regulation (EU) 2019/2099 Of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 [2019] OJ L 322/1 (EMIR 2.2) (n 275).
[752] Priem and Girard (n 103).
[753] Weinstein (n 27).
[754] European Commission, 'Report from the Commission to the European Parliament and the Council under Article 85(1) of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories,' COM(2016) 857, 23 November 2016.
[755] ibid.
[756] European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation

grant ESMA the responsibility of supervising third-country CCPs, subject to proportionate requirements based on whether ESMA determines them to be systemically important or likely to become so (Tier 2 CCPs).[757] Tier 2 CCPs would undergo "dual supervision" from both ESMA and the competent authorities of the third country. ESMA would have complete access to information and possess the same regulatory powers over these Tier 2 CCPs as if they were located within the EU.[758] However, it could be stated that this is problematic because it may create a situation where EU financial institutions face additional compliance burdens and costs when dealing with third-country CCPs. Furthermore, this could hinder cross-border trading activities and limit market efficiency.

Notwithstanding the previous effort to improve EMIR, it is crucial to address another potential issue that demands careful attention and consideration—the impact of these measures on third countries' regulation and CCPs. This critical aspect constitutes the main focus of this thesis, and it was explored in Chapter III and will be thoroughly studied with a case study in Chapter VII, where detailed analysis and discussion will take place.

2.2.6 Regulation 2021/23 "CCP Recovery and Resolution"

Despite the introduction of EMIR and subsequent amendments, derivatives contracts continued to play a vital economic role, serving as essential instruments for risk management and investment strategies.

techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories, COM/2017/0208 final, 4 May 2017.

[757] Weinstein (n 27).

[758] Niamh Moloney, *EU Securities and Financial Markets Regulation* (4th edn, Oxford University Press 2023).

Hence, the inherent complexities and interconnectedness of these contracts still posed risks to financial stability if not adequately addressed.

Therefore, in December 2020 the co-legislators adopted the CCP Recovery and Resolution through the Regulation 2021/23 with the aim of providing an adequate toolkit and enabling orderly resolution in a crisis scenario.[759]

2.2.7 Current Debates and Proposals for Further Improvements

The European Commission Proposals of last December to reduce the exposure of EU financial institutions to third-country CCPs may pose potential challenges.[760] Firstly, implementing such measures could lead to reduced competition in the derivatives market, as some third-country CCPs might face additional barriers to entry or be discouraged from providing services in the EU. This could limit market participants' choices and potentially increase costs for EU financial institutions.

Moreover, the proposals could create regulatory complexities and inconsistencies between different jurisdictions. If third-country CCPs face stricter regulations in the EU compared to their home countries, it might result in regulatory arbitrage and drive business away from the EU, undermining the effectiveness of the intended measures. Harmonizing regulations across jurisdictions is a complex task that requires careful coordination and cooperation between global regulators.[761]

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[759] Regulation (EU) 2021/23 of the European Parliament and of the Council of 16 December 2020 on a framework for the recovery and resolution of central counterparties and amending Regulations (EU) No 1095/2010, (EU) No 648/2012, (EU) No 600/2014, (EU) No 806/2014 and (EU) 2015/2365 and Directives 2002/47/EC, 2004/25/EC, 2007/36/EC, 2014/59/EU and (EU) 2017/1132, OJ [2021] L 22/1, 22.1.2021.

[760] European Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 (n 711); European Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 648/2012 (n 756).

[761] Lehmann, 'Global Rules for a Global Market Place? – The Regulation and Supervision of FinTech Providers' (n 21).

Additionally, the proposals may not fully address the underlying systemic risks in the financial system. While reducing exposure to third-country CCPs is important, it is equally vital to strengthen risk management practices and enhance transparency within the EU's financial ecosystem. Focusing solely on CCPs might overlook other potential sources of risk in the derivatives market and hinder the comprehensive approach needed for safeguarding financial stability.

Overall, while the proposals aim to address legitimate concerns about excessive exposure to third-country CCPs, they must be carefully balanced to avoid unintended consequences and ensure the resilience and competitiveness of the EU's financial markets.

2.3 Analysis of the supervisory framework in the European Union

The supervision of CCPs underwent a significant transformation with the introduction of EMIR 2.2. Initially, under the first version of EMIR in 2012, the responsibility of supervising EU-CCPs was distributed among the national competent authorities (NCAs) of the European Union member states. Each NCA was tasked with overseeing CCPs operating within its jurisdiction. Furthermore, a specialized Supervisory College was established for all supervised CCPs. The primary objective of the Supervisory College was to facilitate information sharing. However, it lacked decision-making authority as decisions were made by ESMA's Board of Governors based on proposals from the CCP Supervisory Committee.[762]

Regarding third-country CCPs, this newly-established body effectively replaces ESMA in all aspects concerning foreign CCPs, except for the creation of the third-country college and the imposition of fees.[763] The

[762] Bianco (n 388).
[763] Weinstein (n 27).

CCP Supervisory Committee acts as a substitute for ESMA in all areas except day-to-day supervision, without being hierarchically subject to ESMA. This shift of power transfers authority from ESMA to the new body.[764] In relation to third-country CCPs, it prepares all draft decisions for the ESMA Board of Supervisors, which must be adopted within a strict schedule of three or ten working days.[765] Since this dissertation focuses on analyzing the external implications of EMIR reform, it will be further analyzed in Chapter VII, Section 3.

2.3.1 Scope of the Supervision of CCPs in EU Law

EMIR regulation is applicable to CCPs and their clearing members, financial counterparties, and trade repositories. Additionally, it may apply to non-financial counterparties and trading venues as provided.

However, when it comes to supervision of CCPs it can be bifurcated into two categories: EU-based CCPs and non-EU CCPs. With the implementation of EMIR 2.2, a radical shift occurred, and CCP supervision was partially transferred to the ESMA through a Supervisory Committee. EMIR 2.2 expanded and formalized the EMIR college-based arrangements, resulting in an augmentation of the colleges' responsibilities.[766] As a consequence, the colleges are now mandated to provide their opinions on qualified shareholdings and approvals of significant outsourcing agreements related to risk management activities.

EMIR 2.2 consolidates the responsibility for monitoring and supervising CCPs, as well as supervisory convergence and risk analysis, into the CCP

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[764] Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (n 108).
[765] ibid.
[766] Recitals 22-24. Regulation (EU) 2019/2099 Of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 [2019] OJ L 322/1 (EMIR 2.2) (n 275).

Supervisory Committee. However, the principal mechanism that reinforces the CCP Supervisory Committee's role in achieving supervisory convergence is the implementation of a novel ex ante consultation procedure.[767] In this procedure, home NCAs are required to submit an extensive array of draft decisions to ESMA for review before their final adoption. Nevertheless, the internal CCP Supervisory Committee is not intended to override the decisions of home NCAs on financially sensitive matters like the default waterfall.[768]

Conversely, the EMIR 2.2 has a different approach regarding third-country CCPs. This regulation aims to enhance the supervision of third-country CCPs by implementing a tiered approach to regulatory regimes. Under this framework, ESMA is granted the authority to determine whether a third-country CCP is, or may become, systemically important (Tier 1).[769] If it is not deemed systemically important, the third-country CCPs would be subject to an equivalence regime (Tier 1). ESMA does not directly supervise or enforce recognized (Tier 1) third-country CCPs. Instead, non-binding cooperation agreements facilitate the exchange of supervisory information between ESMA and the competent authorities in the third country. However, if it is determined to be systematically important (Tier 2), the third-country CCP would be required to comply with the EU regime under the supervision of the CCP Supervisory Committee. This committee, along with a third-country CCP college, will be responsible for formulating draft supervisory and enforcement decisions regarding third-country

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[767] Article 23 (a) (2) Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).

[768] The default waterfall is the term used for a CCP's recovery plan when dealing with clearing member or client defaults. It outlines a comprehensive list of resources that the CCP will utilize in its efforts to recover losses resulting from clearing member defaults. See more on default waterfall: Braithwaite (n 45).

[769] Article 25 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).

CCPs, which will then be subject to final approval by ESMA's Board of Supervisors.

On the other hand, the new third-country CCP supervisory framework affects the internal division of responsibilities between ESMA and the ESCB. More specifically, the CCP Supervisory Committee is required to engage in consultations with the CBIs of all Union currencies of the financial instruments cleared (or to be cleared) 265 by a Tier 2 CCP before presenting its draft decisions on margin and collateral requirements, liquidity risk controls, settlement arrangements, and the approval of interoperability arrangements.[770] Moreover, EMIR 2.2 grants authority to each CBI to impose a defined set of supplementary obligations that Tier 2 CCPs must adhere to in order to obtain recognition.

In this regard, this dissertation focuses on analyzing the external implications of EMIR reform, which are a crucial aspect of the research.

3 Conclusion

The regulation and supervision of CRAs and CCPs in the EU present significant challenges. Throughout this chapter, we have explored the complexities and intricacies of overseeing these critical financial services. The efforts made by regulators to enhance transparency, reduce risks, and protect investors and financial stability are creditable. However, it is crucial to recognize that the task of regulating CRAs and CCPs is far from straightforward, and the potential consequences of regulatory actions must be carefully considered.

As we have seen, the global financial crisis of 2007-2009 exposed the vulnerabilities in the functioning of CRAs and CCPs, prompting a wave of regulatory reforms. The EU has made considerable strides in addressing

[770] Article 24 (b) (1) ibid.

these shortcomings through frameworks such as EMIR and the CRA regulations. Nonetheless, the dynamic nature of financial markets and the interconnectedness of global financial systems make it challenging to achieve a perfect regulatory landscape.

One of the key takeaways from our analysis is the need to consider the external implications of regulatory decisions. The interdependence of EU financial markets with the rest of the world necessitates a careful approach when dealing with third-country CRAs and CCPs. Striking the right balance between imposing rigorous standards and ensuring market access for third-country entities is essential for fostering competition and maintaining a resilient financial ecosystem.

Furthermore, as we move forward, the regulatory authorities must remain vigilant about potential unintended consequences. Implementing new rules and requirements for CRAs and CCPs may have ripple effects on market access, competitiveness, and risk management practices. Moreover, implementing new rules and requirements for CRAs and CCPs may have far-reaching implications, extending beyond the boundaries of the EU, which is a central focus of this research.

CHAPTER VI: THIRD COUNTRIES IN THE CONTEXT OF REGULATION OF CRAS AND CCPS

This chapter is organized to conduct a comprehensive analysis of the relationship between the EU and third countries in the context of regulating Credit Rating Agencies (CRAs) and Central Counterparties (CCPs). By delving into the particulars of this regulatory landscape, we aim to shed light on the concept of third countries in the field of financial services, with a specific focus on CRAs and CCPs. Through this examination, a deeper understanding of the EU's engagement with third countries in the regulation of CRAs and CCPs will be unveiled, offering valuable insights.

It will start with an exploration of the core concept of third countries in the context of financial services in order to establish a foundational understanding. Subsequently, we elucidate the distinctions among access, participation, and the third-country regime within the EU single market. Proceeding to the practical mechanisms available to third countries for EU market entry, specifically equivalence and endorsement, we critically analyze the challenges embedded within these instruments. Transitioning to regulatory dynamics, we meticulously scrutinize the roles played by key entities, such as the European Securities and Markets Authority (ESMA) and the European Commission, in shaping third-country access to the single market. Finally, we unveil the underpinning rationales that drive the EU legislator in formulating these regulations, encompassing the imperative of stability, effective regulation, supervision, and the safeguarding of both financial stability and the integrity of the EU's single market. This chapter offers a comprehensive exploration of these dimensions, aiming to enhance the understanding of third-country involvement within the EU's financial services domain.

1 Literature Review

The concept of third countries holds a fundamental position in the regulatory landscape of financial services within the EU, especially in the field of CRAs and CCPs considering that some of the largest providers of these services are located in a third-country.[771]

A "third country" refers to nations outside the EU. While their involvement in EU trade for goods and services is well explored, their impact on financial services trade is less examined in academic research.[772] However, in recent times, scholars have shown a growing interest in the concept of third countries and their influence on financial services.[773] This interest has been particularly fueled by the Brexit situation, given its significant implications as a financial hub.[774] In particular, scholars have

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[771] Andrey Tomashevskiy and Daniel Yuichi Kono, 'Extra Credit: Preferential Trade Arrangements and Credit Ratings' (2015) 59 International Studies Quarterly 291; Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26).

[772] Mário Soares, 'Access of Third Country Goods and Services to the European Union's Internal Market in Public Procurement' <https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/access-third-country-goods-and-services-european-unions-internal-market-public-procurement>; Bernard Hoekman and Aaditya Mattoo, 'Liberalizing Trade in Services: Lessons from Regional and WTO Negotiations' (2013) 34; Wolfgang Kerber and Roger Van Den Bergh, 'Mutual Recognition in the Global Trade Regime: Lessons from the EU Experience' [2012] Regulating Trade in Services in the EU and the WTO: Trust, Distrust and Economic Integration 121.

[773] OEberg (n 337); Lucia Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in the European Union' (2015) 38 Western European Politics 167; Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11). Leonard Ng, '" Third Country " Issues in Current EU Financial Services Regulation' [2012] *Butterworths Journal of International Banking and Financial Law* 287. Mirzha J De Manuel Aramendía, 'Third Country Rules for Alternative Investments : Passport Flexibility Comes at a Price' (2010) 27.

[774] Sebastian Pitz and Heinrich Nemeczek, 'Brexit, MiFIR and MiFID II: Third-Country Firms Providing Cross-Border Investment Services-An Overview of the Relevant Organisational and Business Conduct Requirements' (2021) 32 European Business Law Review 53; James and Quaglia, '9 Brexit and the Future UK – EU Relationship' (n 240); Morrison (n 259); Berger and Badenhoop (n 590); Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11); Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323); Scott James and Lucia Quaglia, 'Brexit and the Political Economy of Euro-Denominated Clearing' (2021) 28 Review of International Political Economy 505;

explored the complexities surrounding how the EU engages with third countries in terms of market access and regulatory equivalence and endorsement.[775] For instance, Pagliari highlights the challenges of balancing market integration and financial stability when dealing with third-country regulatory regimes.[776] This dilemma becomes evident in the context of the endorsement and equivalence regimes, which allows third-country financial institutions to access the EU market if their regulatory framework is deemed equivalent to EU standard.[777]

Moreover, the interaction between the EU's regulatory framework and third countries is characterized by a blend of legal, political, and economic considerations.[778] Additionally, on an institutional level, the EU has dedicated significant effort to examining the role of third countries within the realm of financial services. This research delves into the mechanisms

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Dirk Schoenmaker, Nicolas Véron and André Sapir, 'Making the Best of Brexit for the EU27 Financial System' (2017).

[775] Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53); Szczepański (n 281); García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241); Deslandes, Dias and Magnus (n 550).Garslian (n 706).

[776] Stefano Pagliari, 'A Wall around Europe? The European Reulatory Response to the Global Financial Crisis and the Turn in Transatlantic Relations' (2013) 35 Journal of European Integration 391.

[777] Amtenbrink and De Haan (n 95); Eddy Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (2017) 15 EBI Working Paper Series 1; Pennesi, 'Equivalence in the Area of Financial Services: An Effective Instrument to Protect Eu Financial Stability in Global Capital Markets?' (n 313).

[778] Huw Jones and Michelle Price, 'Brexit: London Stock Exchange Group Lobbies for US Support in Clearing Battle' (*Independent*, 2017) <https://www.independent.co.uk/news/business/news/brexit-london-stock-exchange-group-us-support-eu-lse-clearing-politics-policy-a8056496.html> accessed 28 November 2023; Scott James and Lucia Quaglia, 'Controversies Over Clearing: Regulation of Derivatives' [2020] The UK and Multi-level Financial Regulation 129; Quaglia, 'The EU and Global Securities Markets Regulation' (n 719); David Sahr and others, 'Brexit: What Are the Options for the Financial Services Industry?' (*Journal of Investment Compliance*, 2016) 45.

established for engagement with third-country CCPs and CRAs, specifically focusing on the concepts of equivalence and endorsement.[779]

On the other hand, except for a few cases like Okonjo and Pennesi, there has been scarce research exploring how the third-country regime in financial services impact financial regulation of third countries and globally.[780] This aspect has primarily been examined from the angle of financial stability, with less attention paid to the legal dimension.[781] Hence, this research seeks to make a valuable contribution to the existing literature by delving into how the mechanisms established to facilitate the access of third-country CRAs and CCPs to the EU single market have the capacity to impact financial regulation of third countries and on a global scale.

In summary, the concept of third countries in the regulation of financial services in the EU is a complex and evolving topic. The literature highlights the need for an approach that considers legal, political, and

[779] European Securities and Markets Authority (ESMA), 'Practical Guidance For the Recognition of Third-Country CCPs' (2021); European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR (18 July 2018) ESMA33-9-24' (n 6); European Securities and Markets Authority (ESMA), 'Final Report Guidelines on the Types and Content of the Provisions of Cooperation Arrangements (Article 79 of CCPRRR)'; Russo and others (n 149); Directorate-General for Internal Policies (European Parliament) and others (n 343); Entrepreneurship and SMEs Directorate-General for Internal Market, Industry, 'New Guidance on the Participation of Third Country Bidders in the EU Procurement Market' (*Press Release*) <https://single-market-economy.ec.europa.eu/news/new-guidance-participation-third-country-bidders-eu-procurement-market-2019-07-24_en> accessed 28 November 2023; European Securities and Markets Authority (ESMA), 'Practical Guidance For the Recognition of Third-Country CCPs'.

[780] Okonjo (n 374); Pennesi, 'Equivalence in the Area of Financial Services: An Effective Instrument to Protect Eu Financial Stability in Global Capital Markets?' (n 313).

[781] Raphaël Douady, Clément Goulet and Pierre Charles Pradier, 'Financial Regulation in the EU: From Resilience to Growth' [2017] Financial Regulation in the EU: From Resilience to Growth 1.

economic aspects to ensure effective market integration while maintaining financial stability and market access.

2 The Concept of “Third Country”

The concept of "third country" in the EU context refers to the geographical origin of citizens, investments, and undertakings. It has been integral to the EU concept from its inception and has evolved over time due to globalization's impact on trade, finance, citizenship, and EU external relations. In recent years, various events, such as Brexit, migration, and energy supply issues, have elevated discussions about the EU's relationship with non-EU countries concerning the exchange of services. “Third-country” is not a standalone creation but rather an inherent part of the EU framework since its establishment. However, its regulation has undergone changes as the EU's engagement with non-EU countries has expanded. Globalization has played a significant role in influencing this evolution, leading to increased utilization of the "third-country" notion in EU law.

The changing dynamics of international trade and finance have necessitated a deeper understanding of the interactions between EU and non-EU entities. As the EU faces various challenges and opportunities in its external relations, the concept of "third country" has gained prominence in scholarly discussions. Indeed, the term "third country" in financial services has garnered increased attention, largely driven by the implications of Brexit. With the United Kingdom's decision to leave the European Union, it has become essential to reevaluate the relationships between the EU and third countries, particularly in the field of financial services.

The way EU and NON-EU financial services suppliers differentiates is clear. Both need to fulfill certain requirements, but usually, financial services

suppliers from a third country need to have some characteristics and authorizations to offer such services in the EU single market as it would occur with any other sovereign state. The EU Treaties do not provide an explicit definition of third countries. Nevertheless, the term "third country" is used to refer to countries that are neither EU members nor part of the European Economic Area (EEA), serving to distinguish them from the Member States.[782] This concept is applied in several fields, but for the scope of this study, it will refer to the legal framework that involves financial services and in particular, CRAs. A definition by analogy proposed by D. Smit identifies third countries are those which are not stated in Article 52 (1) TEU.[783] It becomes relevant for this research because such a definition has an effect on the way the Treaty freedoms apply.[784] Despite the absence of an explicit definition of a third country in the EU Treaties, the term is commonly used in financial services directives and regulations to refer to countries outside the EU and the European Economic Area (EEA). However, the definitions provided in these directives and regulations are not always clear and can sometimes be implied or indirect, referencing other legal acts to establish the meaning of a third country. This lack of a consistent and straightforward definition can create complexities when applying the regulatory framework to third-country financial services providers.

For example, in Regulation No 600/2014 on Markets in Financial Instruments (MiFIR), the term "third-country firm" is defined by making a reference to Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) in Article 4(1)(57). According to this definition, a third-country

[782] Fossum (n 235).
[783] Daniël S Smit, 'Article EU Freedoms, Non-EU Countries and Company Taxation: An Overview and Future Prospect' (2012) 21 EC Tax Review 233, 236.
[784] ibid.

firm is a firm that would be considered a credit institution providing investment services or performing investment activities, or an investment firm if its head office or registered office were located within the European Union.[785]

However, the definition is not very clear and straightforward. This means that it defines a third-country firm by stating what it is not (i.e., a firm located within the EU). As a result, there are several factors that can determine whether a firm is considered a third-country firm, such as where it is established or which regulations and supervision apply to it. Unfortunately, this information is not provided explicitly in the definition, making it somewhat ambiguous.

In contrast, neither CRA Regulation I nor its subsequent amendments provide any explicit definition of a third-country Credit Rating Agency (CRA). A definition of a third-country Credit Rating Agency (CRA) was only introduced in the *Update of the guidelines on the application of the endorsement regime under Article 4(3) of the Credit Rating Agencies Regulation* in 2017, which states: "A CRA which is registered and subject to supervision in a non-EU country or jurisdiction."[786]

The arrival of this definition, albeit delayed, played a crucial role in providing much-needed clarity on the operations and regulatory framework for third-country Credit Rating Agencies (CRAs). It offered valuable insights into the rules and conditions under which these CRAs

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[785] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L 173/349, 12.6.2014; 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 [2014] OJ L 173, 12.6.2014.

[786] European Securities and Markets Authority (ESMA), 'Final Report. Update of the Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation' (n 383).

could function, thus enhancing our understanding of their role in the financial landscape.

3 Access, Participation and Third-Country Regimes Regarding CRAs and CCPs in the EU

3.1 Access and Participation

Participation and access to the EU single market are terms that are often used interchangeably, but in the context of financial services, they carry distinct meanings. While both concepts relate to engaging with the EU single market, they differ in their implications and requirements.

It is important to distinguish that in the context of this research, "Market Access" pertains specifically to the opportunity for a third-country entity to offer its services within the EU.[787] It should not be confused with the broader concept of "Market Access" under the GATS, which is the key liberalizing principle governing trade in services among GATS Members.[788] The usage of "Market Access" in this research is limited to the scope of services provision by third-country actors in the EU's financial markets.

It could be stated that participation in the EU single market goes beyond mere access. It involves a higher degree of integration and alignment with EU rules and regulations. Third countries that participate in the single market may have deeper trade relationships, allowing for a broader range of financial services, investments, and other economic activities. This participation may require adherence to common standards, harmonization of regulations, and acceptance of the principles of the EU's internal market framework. Therefore, in addition to the Member States

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[787] Karel Lannoo, *EU Financial Market Access After Brexit* (2016).

[788] Berger and Badenhoop (n 590); Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26).

it can refer to EU Candidates that have committed to aligning their domestic regulations with EU standards to ensure harmonization and seamless integration with the single market.[789] Consequently, it can be asserted that the level of participation may also fluctuate based on the specific third country in question, as not all third countries share the same trade partnership status with the EU (See Chapter III, Section 7).

On the other hand, access to the EU single market is a term applicable to third countries that are not EU members or candidates. While they may be granted access to specific aspects of the single market, it does not entail full participation. That is the case of several third-country CRAs and CCPs. Access can be achieved through trade agreements, cooperation arrangements, or mutual recognition agreements.[790] However, third countries typically do not have the same level of influence or decision-making power as participating EU members or candidates when it comes to shaping the rules and regulations governing the single market.

For third countries to gain access to the EU single market, they may need to comply with certain conditions and requirements set by the EU. This could include demonstrating regulatory alignment, meeting specific standards, or committing to reciprocal arrangements.

In alignment with the findings of this research, it is evident that access and participation exhibit significant differences. Participation in the EU single market signifies an active integration into the EU's regulatory framework and decision-making processes, while access is more limited and may be subject to certain conditions. Third countries accessing the single market often do so because they see value in engaging with the EU's vast economic zone, even though they may not have full participation

[789] Marja-Liisa Öberg, 'Expanding the Internal Market' (2020) 3685 The Boundaries of the EU Internal Market 9.
[790] Berger and Badenhoop (n 590).

rights. On the other hand, EU members and candidates fully participate in the single market, having committed to the principles and obligations of the EU's legal framework.

When considering credit rating agencies (CRAs), it becomes evident that they are distinct from other financial services in several ways. For instance, many of the ratings provided by CRAs are not directly associated with cross-border transactions, such as ratings for regulatory purposes. Additionally, the market is largely dominated by third-country CRAs.[791] Consequently, it could be stated that the rules governing third-country actors in the EU are not solely promoting liberalization but also addressing the necessity of this service due to the limited number of providers.

This unique situation raises various concerns. Historically, CRAs were largely self-regulated until recently, making their regulatory oversight more challenging.[792] Moreover, credit rating services are not commonly addressed in trade agreements, resulting in a higher degree of discretion in their regulation. Furthermore, the demand for this specific service plays a role in influencing its regulation and market access for certain third countries. Not all CRAs have equal significance, and this discrepancy extends to third countries as well, where some may have more significant market influence and impact than others. As a result, the regulatory landscape for CRAs requires careful consideration to strike a balance between fostering competition and ensuring the stability and integrity of financial markets.

For third-country CCPs, the difference in these concepts can impact their competitive positioning, risk management practices, and relationship with

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[791] Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[792] Eilís Ferran, 'Institutional Design: The Choices for National Systems' in Niamh Moloney, Eilís Ferran and Jennifer Payne (eds), *The Oxford Handbook of Financial Regulation* (First, 2015).

EU counterparts. The forthcoming period will provide insight into the distinctions that will emerge between third-country CCPs, specifically those from the US and the UK, following the Memorandum of Understanding reached between the EU and the UK.[793] As this arrangement is put into practice, it will be of great interest to observe the ways in which third-country CCPs will differentiate themselves based on their geographic origin.

3.2 Third-Country Regimes in Financial Services

The third-country regimes are rules in EU laws that give certain benefits to countries outside the EU and to financial companies from those countries, as long as they meet certain conditions.[794] Therefore, the third-country regimes serve as a fundamental pillar for financial services offered by providers from non-EU countries. Over time, the development of third-country regimes has been gradual, resulting in some challenges regarding its applicability. This distinction arises from the fact that these regimes fall short of the extensive scope of passporting. However, when authorized by the EU, they enable specific regulated activities to be conducted within the EU without requiring individual approval from regulators in EU member states.[795] This dynamic underlines how access and participation can be integral components of third-country regimes for various financial services, like the application of endorsement in the context of CRAs and equivalence in the context of CRAs and CCPs.

The central concern surrounding these regimes is related to the inability to furnish a satisfactory and enduring solution. In the context of third-country CRAs and CCPs, this issue becomes hazardous due to the

[793] Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland (27 June 2023) (n 349).
[794] James and Quaglia, '9 Brexit and the Future UK – EU Relationship' (n 240).
[795] Schoenmaker, Véron and Sapir (n 774).

significant role non-EU providers play and the inherent capacity of these services to trigger systemic risks.

However, a potential shift is on the horizon, potentially attributed to the recently established Memorandum of Understanding with the UK, driven by the continued presence of critical CCPs and CRAs within the UK.[796] Despite this memorandum, the precise outlines of these two services' stipulations remain elusive, necessitating time to ascertain whether concepts like equivalence and endorsement will continue to be integral to third-country regimes in these services, or if a novel system will emerge.

Brexit has had a profound impact on the development of the third-country regimes.[797] However, adapting the regime to the new post-Brexit conditions has proven to be a complex and challenging task.[798] The reactions and preferences of Member States and EU institutions have undergone significant shifts, influenced by political and institutional considerations.[799] These differing positions have created complexities in reaching a consensus on the way forward for the third-country regime. The post-Brexit landscape has highlighted the importance of striking a delicate balance between encouraging liberalization and ensuring financial stability within the EU's financial services sector.[800]

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[796] Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland (27 June 2023) (n 349).

[797] Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).

[798] ibid.

[799] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).

[800] Aneta B Spendzharova, 'Banking Union under Construction: The Impact of Foreign Ownership and Domestic Bank Internationalization on EU Member States' Regulatory Preferences in Banking Supervision' (2014) 21 Review of International Political Economy 949.

4 Instruments Set Out by EU Regulation for CRAs and CCPs to Access the EU Market

In the dynamic landscape of the EU single market, the entry paths for Credit Rating Agencies (CRAs) and Central Counterparties (CCPs) from third countries are marked by distinctive instruments such as equivalence and endorsement (specifically for CRAs). Notably, both CRAs and CCPs share a pivotal aspect in their market access journey – the notion of equivalence. Understanding the significance and implications of these concepts becomes vital in comprehending how these financial services can access the EU single market when originating from third countries.

Regarding third-country CCPs, they can access the EU internal market through the process of recognition by the ESMA. ESMA determines whether a third-country CCP meets the regulatory requirements and is deemed equivalent to the EU's regulatory standards.[801] If ESMA grants recognition, the third-country CCP can offer clearing services for EU-based clients and trading venues.

The recognition process was established through Article 25 of EMIR and it involves a thorough assessment of the CCP's compliance with the EU's rules and regulations, particularly in terms of risk management, capital requirements, and transparency.[802] Moreover, some new rules were recently added declaring that ESMA may impose additional requirements

[801] European Securities and Markets Authority (ESMA), 'Practical Guidance For the Recognition of Third-Country CCPs' (n 779).
[802] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).

on the CCP if it is considered systemically important or poses significant risks to the financial stability of the EU.[803]

After recognition, the third-country CCP will be subject to ongoing supervision and monitoring by ESMA and will be expected to adhere to the same regulatory standards as EU-based CCPs. This process aims to ensure that third-country CCPs operate with a high level of safety and efficiency and contribute to the overall stability of the EU's financial system.

On the other hand, when it comes to third-country CRAs there are two mechanisms. During the negotiation process for the CRA Regulation I in the European Council and Parliament, a significant point of contention was the use of credit ratings issued by agencies from third countries within the EU.[804] The initial proposal by the European Commission did not include any provisions for using these ratings for regulatory purposes, which would have required third-country agencies to establish a subsidiary in Europe to issue ratings acceptable for regulatory use in the EU.[805] However, the EU Council and Parliament recognized the importance of accommodating global agencies and European-supervised entities and, as a result, amended the European Commission's proposal. The modified version allows for the use of ratings issued by third-country agencies for regulatory purposes within the European Union.[806] This is achieved

[803] Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the criteria that ESMA should take into account to determine whether a central counterparty established in a third country is systemically important or likely to become systemically important for the financial stability of the Union or of one or more of its Member States [2020] OJ L 305/7, 21.9.2020.
[804] Rousseau (n 49).
[805] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[806] European Commission Proposal for a Regulation of the European Parliament and of the Council on Credit Rating Agencies {SEC(2008) 2745} {SEC(2008) 2746} (n 599);

through a two-fold mechanism: an endorsement procedure and a certification process based on equivalence.

However, the resistance from the European Commission and certain Member States regarding the acceptance of foreign credit ratings in the EU has had a noticeable impact on the CRA Regulation I's wording.[807] The handling of credit ratings issued by CRAs based in third countries has become excessively complex, and this issue is further aggravated by the stringent interpretation of the endorsement requirements adopted by the European Commission and ESMA.[808]

The determining factor that governs the choice between accessing endorsement or equivalence is the concept of being "systemically important to the financial stability or integrity of financial markets in one or more Member States." Hence, the interpretation of this notion holds significant importance. According to ESMA's guidance on registration, Fitch, Moody's, and S&P groups are considered systematically important and, therefore, are not eligible for certification.[809] On the other hand, for other CRAs, ESMA's guidance suggests that the assessment lies with competent authorities, and before making a decision, ESMA should consult the competent authorities of all Member States to determine if the CRAs' activities are of systemic importance in their respective jurisdictions.[810]

European Commission Proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes (n 569).

[807] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).

[808] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).

[809] European Securities and Markets Authority (ESMA), 'Equivalence' <https://www.esma.europa.eu/policy-activities/benchmarks/equivalence> accessed 28 November 2023.

[810] Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26).

Specifically, the assessment should focus on whether a third-country agency recognized as an External Credit Assessment Institution (ECAI) for the CRD's purposes would automatically be considered "important" for any EU Member State, and consequently, it would not meet the criteria for the certification procedure.[811]

4.1 Endorsement

Article 4.3 of the CRA Regulation offers endorsement for agencies whose ratings significantly impact the financial stability or integrity of financial markets in one or more Member States.[812] The endorsement system under CRA Regulation I enables EU-based agencies, registered in compliance with the regulation, to validate ratings issued by their affiliated entities in third countries (e.g., Moody's Madrid endorsing ratings from Moody's New York) subject to specific conditions.[813] Additionally, CRA Regulation I allows endorsement of ratings issued by agencies not belonging to the endorsing agency's group, provided that the endorsing agency was involved, wholly or partially, in the activities leading to the rating's issuance.[814]

In this regulatory system, third-country-based credit rating agencies are subject to specific legal conditions that must be equally stringent and

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[811] Directive Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176/338, 27.6.2013.

[812] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

[813] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).

[814] European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR (18 July 2018) ESMA33-9-24' (n 6).

comparable to the requirements imposed within the EU.[815] The responsibility for this procedure also lies with the ESMA. As part of its role, ESMA compiles a list of third countries that have regulations deemed to be as stringent as those of the EU.[816] This list serves as a crucial reference point for evaluating the compatibility of third-country-based credit rating agencies with EU standards. Moreover, the endorsement regime required the three major rating agencies (Moody's, Standard & Poor's, and Fitch) to establish an EU subsidiary that falls under the supervision of EU regulators.[817] This subsidiary would be responsible for endorsing the ratings issued by the parent company while maintaining legal accountability.[818] This dual-layered approach aimed to ensure a robust and harmonized oversight of credit rating agencies operating within the EU.[819]

4.1.1 Conditions

The endorsement of a rating is permissible only under certain conditions, including the following:[820]

-The rating must have a valid reason for being issued in a third country.

-The activities leading to the rating must meet the following criteria:

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[815] European Commission, 'Regulating Credit Rating Agencies' <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/regulating-credit-rating-agencies_en>.

[816] European Securities and Markets Authorities (ESMA), CRA Authorisation (7 May 2021), available at: <https://www.esma.europa.eu/supervision/credit-rating-agencies/risk>.

[817] Pagliari (n 776).

[818] Quaglia, 'The EU and Global Securities Markets Regulation' (n 719).

[819] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).

[820] ibid. European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).

a. The endorsing agency ensures and continually demonstrates to ESMA that the third-country agency's rating activities comply with requirements at least as stringent as those in the Regulation (Articles 6 to 12).

b. ESMA's ability to evaluate and supervise the third-country agency's compliance with the Regulation's requirements must not be restricted.

c. The endorsing CRA must provide all necessary information to ESMA upon request for ongoing supervision of compliance with the Regulation's requirements.

The foreign agency issuing the rating should be authorized, registered, and subject to supervision in its home country.

-The legislation in the third country should prevent interference by competent authorities and other public bodies with the methodologies and ratings.

-An appropriate cooperation agreement between ESMA and the competent authority of the third country must be in place.

4.1.2 Responsibility of the Endorsing CRA

The CRA that endorses ratings issued in a third country will bear responsibility for the endorsed ratings and must adhere to the conditions specified in CRA Regulation I.[821] As a result, all the supervisory actions and financial penalties outlined in the regulation (See Chapter V) will apply to the endorsing registered CRA. In this regard, Annex III of CRA Regulation I contains two specific violations concerning endorsement:[822]

"When the CRA endorses a credit rating issued in a third country without adhering to the conditions stated in Article 4(3)(a) to (h), except when

[821] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).
[822] ibid.

the infringement occurs due to reasons beyond the credit rating agency's knowledge or control. This may lead to interpretative challenges regarding the reference to the conditions in Article 4.3.(b) (regarding the foreign CRA meeting requirements as stringent as those set out in Articles 6 to 12).

When the CRA employs the endorsement of a credit rating issued in a third country with the intent of evading the requirements of this Regulation."

Article 4.2 of CRA Regulation I mandates CRAs to unambiguously specify the credit ratings that have undergone endorsement. According to ESMA's guidance on registration, this identification does not necessarily demand a distinct "identifier," as suitable disclosure within ratings publications would suffice.[823] The guidance stipulates that CRAs should also include information about the third-country CRA responsible for issuing the endorsed rating in their disclosure.[824] Such identification can be beneficial for ESMA's supervisory functions; however, it raises concerns as it grants power to a private entity. This move comes after the previous self-regulation regime proved ineffective in addressing the shortcomings in the credit rating industry.

4.1.3 Application for Endorsement

Since the Regulation does not specify the exact procedure for authorities to permit endorsement, ESMA's registration guidance suggests that they should follow the registration procedure outlined in CRA Regulation I.[825] Moreover, ESMA has offered further clarification regarding the specific

[823] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).
[824] ibid.
[825] ibid.

steps that EU CRAs must take when intending to endorse ratings issued by foreign CRAs.[826] During the registration application process, the CRA should notify ESMA of its intention to endorse ratings issued by a foreign CRA. As part of the application package, the EU CRA is required to provide "documents and detailed information related to the expected use of endorsement" (as stated in Annex II.16 of the CRA Regulation I).

4.1.4 Evaluation of Requirements Meeting the Standard of "As Stringent As"

The CRA must present a well-reasoned evaluation of how the rating activities conducted by the third-country CRA, which led to the issuance of credit ratings subject to endorsement, meet requirements that are at least as rigorous as those specified in Articles 6 to 12 of the Regulation.

In this regard, ESMA expects the applicant to furnish comprehensive information and a structured analysis, with detailed reasoning for each requirement outlined in Articles 6 to 12. It is evident that ESMA does not accept the CRA's analysis at face value but conducts its own assessment based on the information provided by the agency.[827] ESMA's approach indicates that CRAs should follow the same methodology employed by ESMA when evaluating the equivalency of a foreign framework with that of the EU. Consequently, the CRA's registration application should include information demonstrating that it has conducted the same tests as ESMA does while assessing the equivalency of third countries' frameworks.

Furthermore, CRAs are required to furnish the procedures established by the EU endorsing CRA to monitor the actual compliance of the third country CRA with these requirements. Additionally, any potential concerns

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[826] European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR (18 July 2018) ESMA33-9-24' (n 6).
[827] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).

identified by the endorsing EU CRA regarding the fulfillment of such requirements must also be provided.

4.1.5 Special Cases: Required Rationale for Third-Country Ratings

The application of a third-country CRA must contain justification for why the ratings are issued in a third country to avoid falling under the jurisdiction of the CRA Regulation I. Specifically, the CRA should provide objective reasons, such as the expertise of analysts, nationalities of rated entities, and the organizational structure of the group of CRAs.[828]

ESMA's Q&A provides several illustrative examples of what could be deemed as objective reasons for determining a rating in a non-EU country under the endorsement regime.[829] These include situations where the CRA has recently established an EU office, and the experienced rating staff for EU entities are based outside the EU, moving their ratings immediately might compromise their quality. Another example is when corporate actions, such as takeovers or mergers, render the current rating irrelevant to the new corporate structures. Furthermore, ESMA emphasizes that moving the rating activity for an issuer or security, which was traditionally conducted by EU-based analysts, should not be acceptable without a valid objective reason.[830] Therefore, in that case third-country CRAs cannot be used.

[828] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).
[829] European Securities and Markets Authority (ESMA), 'Questions and Answers Credit Rating Agencies Regulation' (2023) <https://www.esma.europa.eu/sites/default/files/library/esma33-5-87_questions_and_answers_on_the_implementation_of_the_regulation_eu_no_463_2013_on_credit_rating_agencies.pdf> accessed 28 November 2023.
[830] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).

ESMA appears to hold the view that ratings for issuers based in the EU, or for the securities they issue, should ideally be determined by EU CRAs (or by any subsidiary of global CRAs operating within the EU). Global CRAs, in turn, strive to establish offices in significant national markets to cater to the needs of issuers in those countries or regions. This local presence brings various benefits to both the CRAs and the markets they serve.

Another reason for requiring an EU endorsing CRA is that local analysts possess specific expertise in national industries, which is valuable not only for analyzing credit risk within the local market but also for developing methodologies tailored to national peculiarities.[831] Moreover, being in the same time zone as the issuers they rate and sharing the same language facilitates effective communication and understanding.

Despite the previously mentioned points, CRAs should be allowed the flexibility to globally manage the allocation of their resources. There may be certain scenarios where it could be suitable to assign analytical tasks related to an EU-based issuer to analysts located in other parts of the CRA group.[832] Nevertheless, the CRA Regulation I provides mechanisms to handle such situations, either through outsourcing arrangements with other EU CRAs or third-country CRAs, or by means of endorsement when the analytical resources are situated outside the EU.[833]

[831] Bianco (n 388).
[832] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[833] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

4.1.6 Approval of Endorsement and Endorsing Activity with Registration and Supervision in the Country of Origin

The applicant must specify that the CRA located in the third country is legally authorized or registered and subject to supervision in that jurisdiction.[834] This information should be accompanied by a reference to the specific law or regulation in the third country that grants the authorization or registration and outlines the supervision requirements.[835] Furthermore, the CRA is required to provide supporting documentation, such as an excerpt from the commercial or court register, or other evidence, showing the place of incorporation and the scope of business activity, as of the date of the application.

Lastly, the applicant must provide a copy of the relevant legislation that demonstrates that public authorities in the jurisdiction where the CRA is incorporated are not authorized to interfere with the content of ratings and methodologies used by the CRAs.[836]

After carefully reviewing all the pertinent documentation, ESMA will inform the applicant of its registration decision, indicating whether the endorsement request has been approved or not.[837] As endorsement is an optional activity for the CRA seeking registration, ESMA's guidance on registration suggests that the applicant CRA should be registered if it meets all the registration requirements, even if the specific criteria for

[834] Altman and others (n 49).
[835] Jordan (n 631).
[836] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).
[837] European Securities and Markets Authority (ESMA), 'Guidelines on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation – Supplementary Guidance on How to Assess If a Requirement Is "as Stringent as" the Requirements Set out in CRAR (18 July 2018) ESMA33-9-24' (n 6).

endorsement are not fully met.[838] This implies that the registered CRA would not be permitted to endorse any ratings until it can demonstrate to ESMA its complete compliance with all the conditions outlined in Article 4.3.

If a CRA, which has already completed its registration process, later chooses to endorse ratings from other foreign CRAs, ESMA's guidance on registration suggests that the same registration procedure would be utilized (when applicable) to address all procedural matters, including the application format, deadlines, language, and notifications.[839] The CRA should provide the same information, and ESMA should conduct identical checks as if the endorsement request had been submitted during the initial registration application.[840]

Nevertheless, it is essential to highlight that such a situation would represent a significant alteration to the conditions for the original registration, which must be communicated to ESMA in accordance with Article 14.3 of the Regulation. Unfortunately, both the Regulation and ESMA have not provided explicit guidance on the procedure to be followed by ESMA upon receiving such notifications.

Once ESMA is satisfied, through the aforementioned procedure, that the CRA intending to endorse ratings fulfills the requirements outlined in Article 4.3, the EU CRA should be permitted to commence endorsing ratings without the necessity of obtaining prior approval from ESMA for

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[838] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).
[839] ibid.
[840] Duvillet-Margerit, Mesnard and Magnus (n 10).

individual ratings (thus, supervision would occur ex post).[841] This approach appears to be the most practical way to implement endorsement in practice, as it would be overly burdensome for ESMA to review every rating that is to be endorsed beforehand.[842]

ESMA interpreted that Article 14.3 of the Regulation, which requires a registered CRA to continuously meet the conditions for initial registration, should also apply to the conditions for endorsement. Additionally, as stated in Recital 52, any significant changes in the endorsement regime should be regarded as material alterations to the initial registration conditions of a credit rating agency.

4.2 Equivalence

An equivalence decision is a unilateral assessment conducted by the EU on third countries' regulatory, supervisory, and enforcement frameworks pertaining to specific services, in this case, CRAs and CCPs.[843] Through this evaluation, the EU determines whether the regulatory regimes of these countries align with its own high standards and are comparable in ensuring financial stability and investor protection.[844]

These decisions can be applied in different fields. If the regimes are deemed equivalent by the European Commission, the third country's CRA or CCP is temporarily or indefinitely authorized to operate, partially or

[841] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).
[842] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[843] Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11).
[844] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Equivalence in the Area of Financial Services' (2019) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019DC0349> accessed 28 November 2023.

fully, in the internal market.[845] These equivalence decisions are formalized through a legally binding mechanism known as an implemented or delegated act signed by the institution in charge of executing this task.[846] There are two distinct systems for making equivalence decisions in the EU, each depending on the institution responsible for the decision-making process.[847] In the first method, the European Commission conducts a thorough evaluation of the third country's regulatory, supervisory, and enforcement regimes. Upon finding them compatible with EU standards, the Commission issues an equivalence decision, and its conclusion acts as a source for certain authorizations or approvals.[848] In some of these procedures, the European Commission has support from a European Supervisory Authority (ESA). In the second method, the decision-making process for equivalence lies solely on one of the ESAs, namely, the ESMA, the EBA, or the EIOPA.[849] Each ESA has jurisdiction over specific sectors of the financial industry and is responsible for assessing the comparability of third-country regulatory frameworks within their respective domains

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[845] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).

[846] Alienor Anne Claire Duvillet-Margerit, Benoit Mesnard and Marcel Magnus, 'Third Country Equivalence in EU Banking Legislation. European Parliament. Briefing' (*European Parliament-Economic Governance Support Unit DG Internal Policies Briefing*, 2017) <https://www.europarl.europa.eu/RegData/etudes/BRIE/2016/587369/IPOL_BRI(2016)587369_EN.pdf> accessed 28 November 2023, 4.

[847] Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11), 217.

[848] ibid, 218.

[849] Art. 33 common to Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, *OJ* [2010] L 331/12, 15.12.2010; Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, *OJ* [2010] L 331/48, 15.12.2010; and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, *OJ* [2010] L 331/84, 15.12.2010.

and its conclusion concerns a specific subject.[850] The ESA's assessment is comprehensive and rigorous, taking into account various factors such as the level of investor protection, risk management, and the overall stability of financial markets.[851]

The European Commission presented an evaluation of equivalence in financial services policy in a staff working document.[852] According to the European Commission, equivalence involves striking a balance between the requirements of financial stability and investor protection in the EU, and the advantages of maintaining open and globally integrated EU financial markets.[853] It was in principle seen as a means to promote regulatory convergence. Equivalence is inherently a deregulatory approach that reduces the regulatory burden on financial market participants without eliminating regulations entirely.[854] However, its success relies on the existence of similar, though not identical, rules and practices, as well as mutual trust between jurisdictions. Equivalence is not suitable for areas where regulatory arbitrage and competition between jurisdictions are in play.[855] The Commission highlights that equivalence is most applicable in areas where countries already comply with international standards, but it may not be suitable for all purposes.[856]

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[850] Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11), 218.
[851] Berger and Badenhoop (n 590).
[852] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).
[853] European Commission, 'Equivalence of Non-EU Financial Frameworks' (*European Commission Official Website*) <https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/recognition-non-eu-financial-frameworks-equivalence-decisions_en> accessed 28 November 2023.
[854] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).
[855] ibid.
[856] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).

ESMA's first significant test of the equivalence approach came with the rating agency regime. In this case, ESMA adopted a pragmatic 'objective-based approach' to assess the jurisdiction's ability to meet the objectives of the EU's rating agency regime from a comprehensive perspective.[857] For example, when evaluating the equivalence of the US regime, ESMA concluded that the remaining uncertainties would not significantly detract from a positive equivalence finding. ESMA gained confidence through discussions with the US regulator (the SEC) and believed that the practical application of US requirements would lead to equivalence.[858] Additionally, the equivalence review considered the combined impact of the requirements reviewed, not just individual provisions. Despite its 'second generation' 2017 equivalence advice being detailed and assertive, ESMA maintained a holistic and pragmatic approach.[859] It found that certain jurisdictions' regimes were equivalent to the EU rating agency regime, even if they did not directly align with it, as long as the overall outcome achieved was similar enough.[860]

4.2.1 Equivalence Certificate in CRAs

This system is designed for smaller CRAs from third countries that do not have subsidiaries in the EU, provided they do not have a significant impact on the financial stability or integrity of EU Member States' financial markets.[861] The main advantage of certification, as opposed to endorsement, is that certified agencies are not obligated to establish a

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[857] European Securities and Markets Authority (ESMA), 'Final Report. Technical Advice on CRA Regulatory Equivalence – CRA 3 Update' (n 383).
[858] Minnerop (n 139).
[859] United States Commission Implementing Decision (EU) 2019/1279 of 29 July 2019 (n 372).
[860] Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).
[861] Darbellay (n 63).

subsidiary within the EU.[862] In fact, Recital 14 clarifies that the certification regime is intended for cases where there is a need to adjust the requirement of physical presence in the EU, especially concerning smaller credit rating agencies from third countries that have no existing presence or affiliation within the EU.[863]

4.2.1.1 CRAs' Application for the Certificate of Equivalence

The Regulation imposes an extra requirement for the utilization of the certification regime, which allows its use solely for ratings associated with instruments issued in a third country or for issuers domiciled in a third country. As a result, ratings provided by a certified CRA for issuers based in the EU or for instruments issued within the EU do not qualify for certification and, therefore, cannot be employed by European entities for regulatory purposes.[864]

In addition to the information gathered during the registration process, there are two further disclosures, which are unique to the certification procedure and therefore only mandated for foreign CRAs. These specific disclosures are the following:

-Details about the CRA's Domestic Supervisory Oversight: The applicant is required to provide information confirming that the CRA located in the third country is duly authorized or registered and subject to supervision in that jurisdiction.[865]

[862] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[863] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).
[864] Deipenbrock and Andenas (n 97).
[865] Quaglia, 'The Politics of Regulating Credit Rating Agencies in the European Union' (n 587).

-Details regarding the Systemic Importance of the CRA: The application should include data on the total number of ratings issued by the applicant, categorized by corporate, sovereign, and structured finance.[866]

Moreover, to be deemed equivalent, CRA Regulations establish the following legal and supervisory framework of a third country must meet the following criteria:

-The third country agencies must be under a system of authorization or registration, with ongoing supervision and effective compliance control.

-The third country agencies must adhere to legally binding rules comparable to the substantive requirements specified in the CRA Regulation I (Articles 6 to 12 and Annex I).

-The legislation of the third country should prohibit supervisory authorities and other public entities from interfering with the methods and ratings of the agencies.

The equivalence mechanism does not automatically grant access to the European Union for agencies from the considered third country. Instead, it serves as a preliminary requirement, allowing agencies from that third country to undergo individual assessments.

4.2.1.2 Special cases: Exemptions

During the certification process, the CRA has the option to request an exemption from certain organizational requirements that apply to CRAs operating within the EU. Specifically, as stated in Article 5.4, the CRA has the opportunity to seek exemption from the following:

-On a case-by-case basis from complying with some or all of the requirements laid down in Annex I.A and Article 7 (4) if the CRA is able

[866] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).

to demonstrate that the requirements are not proportionate in view of the nature, scale and complexity of its business and the nature and range of its issuing of credit ratings.

According to ESMA's guidelines, when an applicant seeks an exemption from certain or all requirements outlined in Annex I.A and Article 7(4), they must furnish a comprehensive explanation of the specific Regulation requirement for which they seek an exemption.[867] Additionally, the applicant needs to present the rationale behind their belief that the requirement is not proportionate.

Some authors have stated that the inclusion of these exemptions is puzzling, considering that the certification process demands a prior approval from the European Commission regarding the equivalence of the foreign legislation with that of the EU.[868] This equivalence confirmation inherently includes compliance with the requirements specified in Annex I.A and Article 7(4).

-In cases where the obligation of having a physical presence in the EU would be excessively demanding and disproportionate given the nature, scale, and complexity of its operations, as well as the nature and scope of the ratings it issues, the requirement of physical presence in the EU may be waived.[869]

The exemption of the physical presence requirement in the EU also been questioned by scholars regarding its interpretation because, as previously mentioned, the entire equivalence certification process is designed for CRAs that are not based in the EU.[870] Article 5(1) of CRA Regulation I

[867] European Securities and Markets Authority (ESMA), 'Guidelines on the Scope of the CRA Regulation' (n 383).
[868] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[869] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).
[870] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).

specifically refers to "a credit rating agency established in a third country." Therefore, there is no requirement to be exempted from in the first place. Forcing a foreign CRA to establish a subsidiary in the EU would not be logical, as this subsidiary would then fall under the category of an EU CRA and be obligated to register within the EU.[871] The only plausible explanation is that EU legislators intended to grant ESMA the authority to request the foreign CRA to establish a branch in the EU for supervisory purposes. However, this requirement does not seem justified either, as the certification regime relies on the supervision conducted by the competent authority in the third country.[872]

4.2.1.3 Sanctioning Regime

An essential element of the equivalence certification involves the application of ESMA's sanctioning regime to certified CRAs. Regarding the supervisory measures outlined in Article 24, Article 5.8 of CRA Regulation I, it explicitly states that these provisions shall apply "mutatis mutandis" to certified credit rating agencies and the credit ratings they issue. Consequently, ESMA has the authority to directly impose any supervisory measure on the certified CRA.[873]

However, the Regulation lacks any provision granting ESMA the authority to levy monetary penalties on certified CRAs.[874] As a result, ESMA is not empowered to impose fines or periodic penalty payments on them. By contrast, the enforcement of these penalties is carried out through national competent authorities and follows the civil procedure rules of the Member State where the CRA is located.[875] Enforcing pecuniary sanctions

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[871] ibid.
[872] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).
[873] European Securities and Markets Authority (ESMA), 'Guidelines on the Scope of the CRA Regulation' (n 383).
[874] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[875] Johansson (n 596).

on certified CRAs would have been challenging since they do not have a physical presence within the EU.

In theory, this issue can be resolved through the collaborative interplay of the provisions outlined in Article 5. These include the mandate for the certified CRA to be registered and supervised in its home country, the necessity of an equivalence decision by the European Commission concerning the third country's supervisory and enforcement framework, and the establishment of cooperation agreements between ESMA and the competent authority of the certified CRA. It could be argued that a violation by a certified CRA of a provision in the CRA Regulations may also constitute a breach of its national regulations (assuming they are equivalent to the EU Regulation) and thus result in sanctions imposed by its home country's competent authority. Additionally, under the cooperation arrangements, ESMA could inform and emphasize the necessity of such sanctions.[876] However, the EU requirement violated by the certified CRA might not have a corresponding requirement in the third country's framework. Nevertheless, ESMA retains the option to address these undesirable situations by imposing supervisory measures.[877]

4.2.1.4 Withdrawals of Equivalence Certificate

Equivalence decisions can be used as a strategic instrument as they can be repealed if a later analysis finds that the conditions under which permission was granted have changed.[878] The European Commission then informs the party involved, expressly requesting changes in order to re-establish the initial circumstances.[879] If the third country fails to act

[876] Deipenbrock, 'Direct Supervisory Powers of the European Securities and Markets Authority (ESMA) in the Realm of Credit Rating Agencies-Some Critical Observations in a Broader Context' (n 1).
[877] ibid.
[878] Duvillet-Margerit, Mesnard and Magnus (n 10).
[879] ibid.

accordingly, the equivalence decision will be revoked at short notice.[880] For these reasons, some equivalence decisions can be considered controversial.

There are some relevant and illustrative examples that demonstrate the revocation of equivalence certification for third-country CRAs. These instances shed light on the complexities and considerations involved in maintaining such certification is the case of several decisions concerning CRAs which have been cancelled.[881] In 2019, several crucial equivalence decisions were made concerning third-country credit rating agencies operating in the EU. The countries affected included Australia, Brazil, Singapore, Canada, and Argentina.[882] These decisions had significant implications for the regulatory landscape, highlighting the dynamic nature of the EU's approach to assessing and maintaining equivalence for foreign

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[880] ibid.

[881] European Commission, 'Financial Services: Commission Sets out Its Equivalence Policy with Non-EU Countries' (*European Commission Official Website*, 2019) <https://ec.europa.eu/commission/presscorner/detail/en/ip_19_4309> accessed 28 November 2023.

[882] Ibid.; Commission Implementing Decision (EU) 2019/1276 of 29 July 2019 repealing Commission Implementing Decision 2012/627/EU on the recognition of the legal and supervisory framework of Australia as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies, *OJ* [2019] L 201/17, 30.7.2019; Commission Implementing Decision (EU) 2019/1277 of 29 July 2019 repealing Implementing Decision 2012/630/EU on the recognition of the legal and supervisory framework of Canada as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies C/2019/5801, *OJ* [2019] L 201/20, 30.7.2019; Commission Implementing Decision (EU) 2019/1278 of 29 July 2019 repealing Implementing Decision 2014/248/EU on the recognition of the legal and supervisory framework of Singapore as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies C/2019/5802, *OJ* [2019] L 201/23, 30.7.2019; Commission Implementing Decision (EU) 2019/1281 of 29 July 2019 repealing Implementing Decision 2014/245/EU on the recognition of the legal and supervisory framework of Brazil as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies C/2019/5805, *OJ* [2019] L 201/34, 30.7.2019; Commission Implementing Decision (EU) 2019/1282 of 29 July 2019 repealing Implementing Decision 2014/246/EU on the recognition of the legal and supervisory framework of Argentina as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies C/2019/5806, *OJ* [2019] L 201/37, 30.7.2019.

CRAs. The European Commission sent communications in advance, noting that the legal framework of CRAs had changed in the EU through CRA Regulation III in 2013 and stating that the recipients' corresponding regulations should, therefore, comply with this reform.[883] Hence, the alternative was to modify internal legislation to create new laws having the same effects as those of the EU. For this reason, this is a case of territorial extension of EU law.[884] Despite several years having elapsed since the communication and the required changes not being implemented, the European Commission took action and decided to withdraw the previous equivalence certification it had granted to those CRAs. This decision was a consequence of their failure to align with the updated legal framework for CRAs in the EU.

As part of this process, credit ratings from Argentina, Australia, Brazil, Canada, and Singapore were no longer considered equivalent due to the weakening of their regulations[885] Some authors expressed their concern because of the legal uncertainty associated with relying on equivalence and the restricted market access for countries with Free Trade Agreements (FTAs) with the EU.[886] The Australian case will be further developed in Chapter VII as a case study.

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[883] European Commission, 'Financial Services: Commission Sets out Its Equivalence Policy with Non-EU Countries' (n 881).

[884] This case will be further discussed in Chapter VII.

[885] H Jones, 'EU Signals Tighter Financial Market Access after Brexit' (*Reuters*, 2019) <https://www.reuters.com/article/us-britain-eu-financial-idUSKCN1UO1FN> accessed 28 November 2023; Huileng Tan, 'The EU Is Reportedly Stripping 5 Countries of Some Market Access Rights'' (*Economy*, 2019) <https://www.cnbc.com/2019/07/29/eu-to-strip-canada-brazil-singapore-of-market-access-rights-ft.html> accessed 28 November 2023.

[886] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317); Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).

4.2.2 Equivalence Recognition in CCPs

Third-country CCPs can access the EU clearing market upon equivalence recognition by ESMA.[887] This recognition by ESMA is conditional for the European Commission to adopt an equivalence decision, which ensures that the third country's legal framework provides an effective and equivalent system for recognizing CCPs authorized under third-country regulations. This condition indicates a requirement for some form of reciprocity between the regulatory provisions of the EU and third countries.[888]

The EMIR 2.2 proposal introduced a notable shift for third-country CCPs, organizing them into a three-tier system. The previous third-country regime now applies exclusively to CCPs verified as not systemically important or not likely to become systemically important (Tier 1 CCPs) whereas the systematically important CCPs (Tier 2 and Tier 3) have additional requirements.

4.2.2.1 CCPs' Application for the Equivalence Recognition

According to EMIR, third-country recognition is contingent on meeting four conditions. Initially, the EU Commission must adopt an implementing act affirming that the concerned third country possesses a comparable legal and supervisory framework for CCPs, ensures ongoing effective supervision, and maintains an equivalent recognition regime for third-country CCPs. The second condition necessitates that the CCP be duly authorized in its home country and be subject to rigorous supervision and enforcement to ensure complete adherence to the prudential requirements of that third country. The third condition requires ESMA to

[887] European Securities and Markets Authority (ESMA), 'Practical Guidance For the Recognition of Third-Country CCPs' (n 779).

[888] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).

have a cooperation arrangement with the third country based on the determination of equivalent legal and supervisory frameworks. These arrangements must outline information mechanisms, particularly for timely notification of legal infringements, and coordination procedures for supervisory activities, including on-site inspections. The fourth requirement is that the third country must have anti-money laundering and combating the financing of terrorism systems that are equivalent to those of the EU.

Tier 2-CCPs, on the other hand, are subjected to distinct and more stringent requirements. The new system (Tier 2 CCPs) undergoes a significant change as the European Commission gains the authority to link the operation of its implementing act, pertaining to the equivalence of legal standards, with the effective fulfillment of equivalence requirements.[889] Consequently, this allows for continuous monitoring of the regulatory standards of third countries by ESMA. It gained immediate and notable criticism from various stakeholders and experts in the financial industry. For instance, London-based CCPs have described this as a direct threat to their business.[890]

For third-country CCPs classified as systemically important or likely to become so (Tier 2 CCPs), the amendment introduced a fresh set of regulatory and supervisory obligations. ESMA is responsible for determining whether a third-country CCP falls under the category of systemically important or is likely to become one. Once identified as systemically important, the CCP would be required to meet all the EMIR obligations for CCPs, as well as any additional requirements imposed by

[889] Regulation (EU) 2019/2099 Of the European Parliament and of the Council of 23 October 2019 amending Regulation (EU) No 648/2012 [2019] OJ L 322/1 (EMIR 2.2) (n 275).
[890] Berger and Badenhoop (n 590).

the central banks of the relevant EU currencies cleared or to be cleared, to support their monetary policy tasks. Nevertheless, a CCP falling under this category could seek a derogation if ESMA deems that its home country's regulations are equivalent to EMIR (referred to as "comparable compliance"). Tier 2 CCPs are subject to direct supervision by ESMA. Hence, ESMA consistently oversees their adherence to regulations through a wide range of supervisory measures, including routine data inquiries, general assessments, and on-site inspections.[891] In the third category (Tier 3), a third country CCP could even be forced to relocate into and be licensed in the EU territory. This would be the case if upon ESMA's recommendation the European Commission deemed the third country CCP to be so systemically important that the respect for EMIR and ESMA's cross-border supervision would not in itself suffice to ensure financial stability within the EU.[892] However, as of yet, ESMA has refrained from categorizing any third-country CCP within that classification.

ESMA is responsible for overseeing the activities of Tier 2 TC-CCPs to ensure their continuous compliance with the relevant EMIR requirements, as stated in Article 25 (b). It conducts comprehensive reviews of key decisions, such as the expansion of services or significant changes to risk models, supported by enhanced cooperation arrangements and enforcement powers.[893] If necessary, ESMA can propose remedial actions to safeguard the stability of the EU's financial system and mitigate the potential risk of a CCP failure.[894]

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[891] Weinstein (n 27).
[892] Berger and Badenhoop (n 590).
[893] European Securities and Markets Authority (ESMA), 'Practical Guidance For the Recognition of Third-Country CCPs' (n 779).
[894] Heath and others (n 24).

In this regard, on March 13, 2019, Christopher Giancarlo, the Chairman of the US Commodity Futures Trading Commission (CFTC), expressed concerns to the European Commission and other EU authorities about the implementation of EMIR 2.2 and its potential impact on US CCPs and the broader US financial market.[895] Although the specific concerns were not explicitly mentioned in his statement, they can be inferred from the rest of the press release. The CFTC Chairman emphasized the importance of national regulatory authorities embracing deference and applying it to jurisdictions with comparable regulatory and supervisory regimes. Prior to this, the CFTC Chairman had already asserted the expectation that non-US regulators should defer to the CFTC's oversight of the US derivatives market. He also warned against overlapping, duplicative, and possibly conflicting regulations that could hinder global economic recovery.[896]In the previous sections, this research has brought light to two instruments, which pertain to the market access of CRAs and CCPs providers from third countries.

4.2.2.2 “Shared Control” of CCP’s Supervision

Lehmann has introduced the ground-breaking concept of "Shared Control" to articulate the interaction between the EU and third countries regarding the access of third-country CCPs within the EU.[897] This innovative concept is complexly linked with supervisory cooperation established by Article 25 2 (b) of EMIR 2.2 and particularly pertains to CCPs categorized as Tier 2. Lehmann states that the control over CCPs is shared because the financial authority of the CCP's home country continues to hold primary supervisory authority over the CCP and the access and enforcement of

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[895] Christopher Giancarlo, ‘Statement of Chairman J. Christopher Giancarlo on EMIR 2.2’ (2019).
[896] Lehmann, ‘CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control’ (n 108).
[897] ibid.

other countries into the home country's jurisdictional space is contingent upon its consent.[898] The home country's consent can be formalized through mechanisms such as memoranda of understanding or cooperation arrangements.[899] Although these arrangements might not be legally binding, they carry considerable practical significance.

4.2.2.3 Withdrawals of Equivalence Recognition

According to Article 25 (5) of EMIR, ESMA, after consulting the authorities and entities mentioned in paragraph (3), will reassess the recognition of a third-country CCP if that CCP expands its activities and services in the EU.[900] This review will follow the guidelines outlined in paragraphs (2), (3), and (4). Moreover, ESMA has the authority to revoke the recognition of the CCP if the conditions outlined in paragraph 2 are no longer met, and under the same circumstances described in Article 20.

4.2.3 Recent Developments in Implementing Equivalence

The EU has taken steps to strengthen its equivalence rules for third countries, announcing more detailed assessments for "high impact" third countries.[901] The Commission has published a Communication outlining the new approach to "equivalence in the area of financial services".[902] It emphasizes the need for dynamic responses to external regulatory and

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[898] ibid.

[899] Lev Bromberg, Andrew Godwin and Ian Ramsay, 'Cross-Border Cooperation in Financial Regulation: Crossing the Fintech Bridge' (2018) 13 Capital Markets Law Journal 59.

[900] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).

[901] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).

[902] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Equivalence in the Area of Financial Services' (n 844).

supervisory developments that could affect market participants in the EU. The approach aims to establish a resilient and effective prudential framework, taking into consideration not only financial stability but also market integrity, investor protection, and a level-playing field in the internal market to avoid conflicting requirements and regulatory arbitrage. The EU views the equivalence regime as a flexible regulatory tool capable of bridging jurisdictional gaps and fostering cross-border business.[903] However, it calls for a risk-sensitive assessment and ongoing compliance checks.[904] The new policy framework does not indicate a move towards the UK's demand for "enhanced equivalence." Instead, the EU is moving towards higher quality requirements for continued equivalence, which could limit the UK's ability to diverge from EU regulatory and supervision standards after Brexit.[905]

4.2.4 Equivalence and Endorsement Challenges for Third-Country CRAs and CCPs within the EU Regulatory Framework

While the equivalence regime ostensibly addresses access to the Single Market and trade in financial services with third countries, scholars have underscored that its foundation is flawed by concerns over transparency, legal certainty and its unilateral decision-making nature.[906] The EU's approach to equivalence is customized or adapted to suit the specific needs of the areas in which it is implemented. However, for equivalence

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[903] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3).
[904] ibid.
[905] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).
[906] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53); Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53); Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317); Pennesi, 'Equivalence in the Area of Financial Services: An Effective Instrument to Protect Eu Financial Stability in Global Capital Markets?' (n 313).

to be granted, comparable requirements that are legally binding, effectively supervised, and yield the same outcomes must be in place.[907]

Moreover, certain areas may also consider data protection, anti-money laundering issues, and the tax rules of third countries as relevant factors.[908] Nevertheless, it is crucial to acknowledge that there is a diverse range of EU financial laws that do not incorporate equivalence provisions. In the case of third-country CRAs and CCPs, the existing scenario is compounded by the fact that the legal certainty the equivalence provisions offer is inherently fragile, primarily because a considerable number of these provisions are scheduled for periodic reviews or are even conducted on an ad hoc basis.[909]

On the other hand, within EU law, the third-country regime has been consistently marked by a deference principle.[910] Hence, this approach aligns with the established patterns. Additionally, the EU has successfully cultivated a unified market, wherein its Member States relinquished certain dimensions of their sovereignty. Consequently, the EU retains the authority to shape its entry criteria as deemed appropriate. However, this process necessitates a careful balancing act, considering international trade regulations governing market accessibility.

Furthermore, equivalence decisions and endorsement carry implications that extend beyond the confines of the EU, significantly affecting both financial stability and the integration of financial markets on a global

[907] Dieter Pesendorfer, 'Introduction', *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (2020).
[908] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).
[909] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).
[910] Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).

scale. Consequently, a perpetual conundrum arises, opposing regulatory measures aimed at ensuring financial stability against those that foster market liberalization. As Moloney puts it, this dilemma can be interpreted as a regulatory collective action challenge.[911]

In contrast, the denial or withdrawal of equivalence and endorsement can prompt adjustments in the regulatory, supervisory, or enforcement mechanisms of the third country to align with EU benchmarks. This transformation need not inherently be detrimental, yet it might be perceived as an imposition. This dynamic clearly exemplifies how the territorial jurisdiction of EU law extends its influence on a global scale through territorial extension in this particular case.[912] This phenomenon emerges due to the necessity for a non-EU jurisdiction's regulations to undergo adaptation to mirror or produce analogous outcomes to those prevailing within the EU. Consequently, regulations governing CRAs or CCPs in different regions achieve a semblance of uniformity, with the EU effectively setting the precedent. This process underscores the expansion of EU law's jurisdiction into external spheres and is illustrative of the de jure "Brussels effect".[913]

This territorial extension of EU law across territories requires meticulous consideration within both the framework of endorsement and equivalence decision-making and the legislative process pertaining to financial

[911] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[912] Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32). The essence of this paragraph centers around the concept of territorial extension, which is exemplified by the scenario presented wherein the withdrawal of an equivalence decision or endorsement requires the third country's adjustment of its internal legal framework for reestablishment of the recognition. This example highlights the notion of territorial extension, as the EU's regulatory influence extends beyond its borders. However, it's important to acknowledge that extraterritoriality also comes into play, exemplified by the EMIR 2.2 supervision provision. This part grants ESMA the authority to oversee CCPs located in third countries, a theme extensively explored in Chapter VII.
[913] Bradford, 'The Brussels Effect: How the European Union Rules the World' (n 36).

services, particularly when incorporating endorsement and equivalence provisions. Such recognition becomes essential as it holds the potential to contribute to the consolidation of financial markets and the harmonization of international economic law, helping to have a more integrated and coherent global financial landscape.

Nonetheless, in the current scenario, determinations affecting to market access lack consideration for the potential impact on third countries' financial markets and legislation, which could result from the incorporation of amendments to internal regulations. It can happen because a particular legal provision for CRAs or CCPs within the EU may not necessarily mirror that of a third country, given the distinct attributes and requirements of its own market environment.

Furthermore, the situation surrounding the equivalence decision regarding stock exchanges and Switzerland in 2019 raised notable concerns, primarily due to the potentially political nature of its application.[914] Such approaches could have a negative impact on the financial services sector. Moreover, despite the overarching goal of CRAs and CCPs legislation being to keep financial stability and cooperation in financial affairs, there is a risk that they might not foster harmonization. Instead, potential disagreements could trigger power struggles within the financial industry among different nations.[915]

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[914] This case will not be subject to examination within the context of this research since it is not one of the financial services that constitute the scope of this study. However, it is essential to highlight this example because it underscores the potential for any equivalence decision to be vulnerable to the same outcome. Furthermore, this decision's significance is magnified in the context of CCPs and Brexit, where the necessity for political agreements could potentially impact the formulation of equivalence decisions. See more on the Swiss case in footnote 331.

[915] Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).

A potential dispute, however, should not encourage the EU to abandon its autonomy in decision-making or to indiscriminately open its doors to any interested third country. Rather, the primary goal is to attain a more refined and precise regulatory framework.

4.2.4.1 Relationship between Endorsement and Certification Based on Equivalence in Third-Country CRAs.

The interplay between the two distinct systems within CRA Regulation for using third-country ratings has sparked intriguing discussions among authorities, the European Commission, and CRAs.[916] The focal point of these debates has centred on interpreting the conditions for endorsement that the third-country CRA must meet as specified in Article 4 (3)(b): "the credit rating activities conducted by the third-country credit rating agency leading to the issuance of the credit rating to be endorsed comply with requirements that are at least as rigorous as those outlined in Articles 6 to 12".

Market participants and leading CRAs comprehend that these requirements should be derived from the actions of the third-country CRA ("conduct"), whereas the European Commission's services (in an informal stance communicated to ESMA and not officially published) contend that the requirements should be grounded in the legislation of the third country.[917]

Authors have stated that the consensus among legislators, as manifested in the Regulation, necessitates that the stringency of requirements be

[916] Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92).
[917] The term "conduct" is crucial because it is the key factor that creates territorial extension as defined by Scott. It occurs because the European Union is evaluating a third country's behavior. Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32). See more in Chapter II, Section 3.

based on the business conduct of the third-country CRA, not on its legislation.[918]During the discussions in the autumn of 2010 to amend the CRA Regulation, numerous Member States, including the UK, Spain, the Netherlands, Sweden, Austria, Finland, Hungary, and Ireland, supported this interpretation.[919] They collectively submitted a joint declaration to the EU Council, expressing that ESMA should issue and update guidelines on the application of the endorsement regime clarifying the "conduct" aspect.[920]

Regarding this matter, the European Parliament provided further explanation on the "conduct" aspect in its June 2011 Resolution as follows:[921]

"The European Parliament (…) 14. Reiterates that Regulation (EC) No 1060/2009 devises two systems to deal with external credit ratings from third countries and that the intention behind the endorsement regime was to allow external credit ratings from third countries deemed non-equivalent to be used in the European Union if clear responsibility was attached to an endorsing CRA."

As acknowledged in the European Parliament's resolution, the endorsement mechanism was deliberately designed to be substantially different from the equivalence regime. If the conditions outlined in Article 4.3.(b) were to be based on local regulations evaluated by ESMA, it would essentially replicate the equivalence regime, with one crucial distinction:

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[918] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[919] Anja Theis and Michael Wolgast, 'Regulation and Reform of Rating Agencies in the European Union: An Insurance Industry Perspective' (2012) 37 Geneva Papers on Risk and Insurance: Issues and Practice 47.
[920] European Banking Federation, 'Response to ESMA Consultation Paper on the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Regulation 1060/2009' (2011).
[921] Credit rating agencies European Parliament resolution of 8 June 2011 on credit rating agencies: future perspectives (2010/2302(INI)).

ESMA would determine the equivalence of the third country framework instead of the European Commission.[922] ESMA would conduct the assessment and make determinations regarding the equivalency of the third country framework while considering applications for endorsement or ratings issued by foreign CRAs.

Furthermore, the language used in Recital 13 of the Regulation underscores that *"credit rating agencies should determine and monitor, on an ongoing basis whether the credit rating activities resulting in the issuing of such a credit rating comply with (…)"*, placing a strong emphasis on the CRA's conduct or "activities" rather than on the foreign legislation. Consequently, throughout CRA Regulation I, the endorsement regime consistently refers to "conduct" or "activities" when defining its requirements, whereas the certification regime, in contrast, refers to "legally binding rules" in Article 5 (6) (b) and "legal and supervisory framework" in Article 5 (1) (b) when outlining the equivalence certification's instructions.

Additionally, the Regulation mandates that ESMA possesses the capability to "evaluate and supervise the adherence" of the third country CRA to the requirements stated in Article 4 (3) (b) (c). Furthermore, Article 4 (3) (d) states that the endorsing CRA is obligated to provide all essential information, upon request, to facilitate ESMA's ongoing supervision and assessment of compliance.

Based on this, it can be inferred that the endorsement regime establishes both legal responsibility for the actions of the third country CRA and an effective means to monitor adherence to EU requirements.[923] This outcome results from assessing the conduct of the CRA in the third

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[922] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[923] ibid.

country, rather than relying solely on the third country's regulatory regime.

ESMA's position, which diverged from the wording and intent of the CRA Regulation, raised significant concerns in the market. As a result, EU legislators mandated ESMA, in collaboration with EBA and EIOPA, to issue and update guidelines on the implementation of the endorsement regime as indicated in Article 21 (3) amended by the CRA Regulation II.[924] In response, ESMA published a consultation paper in March 2011 to gather feedback from market participants and subsequently released its final guidance in May 2011, reaffirming its previous interpretation.[925]

The practical implication of this interpretation is that EU CRAs are not able to endorse ratings from third country CRAs unless the legislation in that third country is equivalent to the CRAs Regulation. This situation could create significant challenges for European institutions, given that they previously relied on ratings from third country CRAs without any restrictions (often without considering the specific entity within the group that issued the rating).[926]

4.2.4.2 Comparable Compliance

Comparable compliance was a term originally introduced through Article 25 (a) of EMIR and later complemented with the Commission Delegated Regulation 2020/1303 of 14 July 2020.[927] It established that ESMA's

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[924] 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 [2011] OJ L 145/30 (CRA Regulation II) (n 99).

[925] European Securities and Markets Authority (ESMA), 'Consultation Paper ESMA Guidelines on the Application of the Endorsement Regime under Arti- Cle 4 (3) of the Credit Rating Regulation 1060/2009'.

[926] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).

[927] Commission Delegated Regulation (EU) 2020/1303 of 14 July 2020 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council(n 803);Commission Delegated Regulation (EU) supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to the minimum

recognition of Tier 2 CCPs is contingent upon their adherence to the stipulations of Article 16 (pertaining to capital requirements), Title IV (comprising CCP requirements encompassing organizational, conduct of business, and prudential aspects), and Title V (encompassing requirements related to interoperability arrangements) of EMIR.

This mechanism, allows these CCPs to be regarded as in compliance with these provisions by virtue of adhering to the corresponding requirements applicable within the relevant third country. However, this mechanism has been the subject of significant contention, even drawing concerns from ESMA itself. ESMA has expressed reservations about the efficacy of this mechanism, highlighting its limitations in terms of providing ESMA with adequate tools to effectively use it since it lacks the necessary provisions for ESMA to comprehensively evaluate alignment with EMIR and it does not offer ESMA the flexibility to consider the extent of systemic significance associated with the Tier 2 CCP under assessment.[928]

4.3 Cooperation Arrangements between the EU and Third Countries

In both the endorsement and certification processes, the CRA Regulation and EMIR mandate the establishment of cooperation arrangements between ESMA and the foreign competent authorities.[929] These arrangements must outline the information exchange mechanism between the respective competent authorities and the procedures

elements to be assessed by ESMA when assessing third-country CCPs' requests for comparable compliance and the modalities and conditions of that assessment 14 July 2020 C (2020) 4895 final (Commission Delgated Regulation on Comparable Compliance) (n 275).

[928] European Securities and Markets Authority (ESMA), 'Assessment Report under Article 25(2c) of EMIR. Assessment of LCH Ltd and ICE Clear Europe Ltd. Part 1'.

[929] Lastra (n 207).

governing supervisory activity coordination.[930] Hence, ESMA developed guidelines in order to indicate how these cooperation arrangements must be negotiated and designed.[931]

It is crucial to comprehend that these arrangements should not be mistaken for international agreements; rather, they are in the form of Memoranda of Understanding (MoUs). MoUs are bilateral agreements between regulatory bodies or authorities of different jurisdictions, outlining the terms and procedures for cooperation, information exchange, and coordination. While not legally binding treaties, MoUs play a significant role in establishing a structured framework for collaboration and mutual support between regulatory entities across borders.

Cooperation arrangements are essential to ensure that the regulatory and supervisory efforts of different countries are aligned and effective in overseeing CRAs and CCPs' activities. They typically outline the procedures for sharing relevant information, conducting joint inspections or investigations, and coordinating enforcement actions, among other aspects.[932]

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[930] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[931] European Securities and Markets Authority (ESMA), 'Guidelines on Cooperation Arrangements and Information Exchange between Competent Authorities and ESMA' (2014); European Securities and Markets Authority (ESMA), 'Final Report Guidelines on the Types and Content of the Provisions of Cooperation Arrangements (Article 79 of CCPRRR)' (n 779).
[932] European Securities and Markets Authority (ESMA), 'Guidelines on Cooperation Arrangements and Information Exchange between Competent Authorities and ESMA' (n 931).European Securities and Markets Authority (ESMA), 'Final Report Guidelines on the Types and Content of the Provisions of Cooperation Arrangements (Article 79 of CCPRRR)' (n 779).

5 EU Institutions and Their Role in the Development of a Legal Approach Towards Financial Services Providers from Third Countries

5.1 The European Commission

The European Commission holds a unique and fundamental role in financial regulation pertaining to third-country CRAs and CCPs. However, this role has also been a subject of considerable controversy due to the inherently political nature of this institution's responsibilities.[933]

In this regard, the European Commission has referred to some mechanisms of access to the EU single market, such as equivalence, as instruments mainly intended to safeguard the EU's financial stability and then to allow interaction with third countries.[934] Hence, the role of the European Commission is crucial, particularly in cases where it holds the authority to determine whether a third-country supplier can gain access to the market. Furthermore, when considering third-country CRAs and CCPs, it becomes evident from the standpoint of the European Commission that a dichotomy within the EU exists—a balance between prioritizing financial stability and ensuring open market access.

Creating broader rules for the systems overseen by the European Commission could help resolve this conflict. Some authors have suggested forming a general framework that could be used to judge whether a third-country provider should be allowed into the market. This could significantly improve the current situation.[935] Right now, decisions

[933] Eisl (n 247), 13.
[934] Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53).
[935] Eddy Wymeersch, 'Brexit and the Provision of Financial Services into the EU and into the UK' 15 European Company and Financial Law Review 733.

are being made bit by bit for each state, and this could cause even more issues.

5.2 The ESMA

ESMA has the authority to issue guidelines and recommendations aimed at establishing consistent, efficient, and effective supervisory practices.[936] These guidelines or recommendations can be directed to competent authorities or even directly to financial market participants. While technically non-binding, they hold significant weight as a form of soft law.[937] Both competent authorities and financial market participants are expected to make every effort to adhere to these guidelines. If a national authority chooses not to comply, it is required to provide justification for its decision.[938] ESMA has the power to publicly disclose instances where a competent authority does not intend to comply and may also publish the

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[936] Researchers have highlighted significant constitutional challenges in the expansion of powers for EU agencies and have specifically examined the *Meroni doctrine*, which emphasized the principle of not delegating regulatory responsibilities to agencies that were not explicitly authorized by the Treaties to hold such powers. See, in particular:
S Andoura and P Timmerman, 'Governance of the EU: The reform debate on European agencies reignited', (2008) EPIN Working Paper No. 19, available at <http://aei.pitt.edu/11474/1/1736. pdf> accessed 28 November 2023; J-P Schneider, 'A common framework for decentralized EU agencies and the Meroni doctrine' (2009) 61 Administrative Law Review 29; E Chiti, 'An important part of the EU's institutional machinery: Features, problems and perspectives of European agencies' (2009) 46 Common Market Law Review 1395, 1420–24; S Griller and A Orator, 'Everything under control? The "way forward" for European agencies in the footsteps of the Meroni doctrine' (2010) 35 European Law Review 3, 3–15; HCH Hofmann, 'Agency design in the European Union' (2010) 28 Windsor Yearbook of Access to Justice 309, 316–19; C F Sabel and J Zeitlin (eds), Experimentalist Governance in the European Union. Towards a New Architecture (Oxford: Oxford University Press, 2010); M Chamon, 'EU agencies: Does the Meroni doctrine make sense?' (2010) 17 Maastricht Journal of European and Comparative Law 281; M Chamon, 'EU agencies between Meroni and Romano or the devil and the deep blue sea' (2011) 48 Common Market Law Review 1055; HCH Hofmann and A Morini, 'Constitutional aspects of the pluralisation of the EU executive through "agencification"' (2012) European Law Review 419.
[937] Ferran and Alexander (n 560).
[938] Tridimas (n 589).

reasons behind the non-compliance.[939] Such disclosure serves as an enforcement mechanism in this context.

6 Exploring the Underlying Rationale of the EU’s Regulatory Framework for Third-Country CRAs and CCPs

The regulation of CRAs and Central Counterparties CCPs within the EU arises from a complex interplay of various needs and objectives. At its core, there is a compelling need for stability within the financial sector. With the potential to impact market integrity, investor confidence, and the overall health of the economy, CRAs and CCPs must adhere to stringent standards to ensure their operations do not become sources of systemic risk. Effectiveness in regulation and supervision is paramount, ensuring that these entities operate within established parameters and comply with rules that prevent undue market disruptions. Simultaneously, safeguarding the EU's financial stability is a paramount concern, given the interconnectedness of global financial systems. This underscores the importance of a harmonized regulatory framework, one that maintains consistent standards for CRAs and CCPs operating within and beyond EU borders. Moreover, this regulatory initiative aligns with the need to safeguard the integrity of the EU single market, promoting fair competition and investor protection. Ultimately, addressing these multifaceted needs highlights the complexities of balancing market access, regulatory consistency, and stability in a rapidly evolving financial landscape.

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[939] Canini (n 107).

6.1 The Need for Effective Regulation

To enhance the stability of the financial sector, any financial institution involved in financial intermediation and risk management requires adequate prudential regulation and supervision.[940] This is particularly crucial for banks, as the failure of even a few institutions can trigger a systemic crisis, leading to a loss of confidence and potential bank runs.[941] Such crises can undermine macroeconomic stability and overall economic activity.

Furthermore, financial regulation must guarantee the effective resolution of recognized market deficiencies and wider economic and societal necessities, both domestically and internationally.[942] This involves maximizing the utilization of all available regulatory mechanisms and tools to attain policy goals, which includes synergizing regulation with other policy instruments to achieve comprehensive outcomes.

Due to these factors, the EU has been actively shaping regulations since the initiation of the Single European Act.[943] This process has involved various tools and informal guidelines to ensure that rules are not only properly put into practice but also achieve their intended outcomes. However, in the context of dealing with third countries, certain aspects of these regulations have proven problematic. One notable issue is the uncertainty that has arisen, particularly concerning the concept of

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[940] Ronaldo Hilario and others, 'Opening Markets in Financial Services and the Roles of the Gats' (1997).

[941] Valia Babis, 'The Single Rulebook and the European Banking Authority' in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook in European Economic Law* (Edward Elgar Publishing 2019).

[942] Organisation for Economic Co-operation and Development (OECD), 'Policy Framework for Effective and Efficient Financial Regulation. Gneral Guidance and High Level Checklist' (2010).

[943] Rainer Kattel, Jan Kregel and Mario Tonveronachi, *Financial Regulation in the European Union* (Routledge 2016).

equivalence.[944] This uncertainty needs to be tackled to ensure that regulations surrounding third-country participation become more effective and reliable.

6.2 The Problem of Legal Harmonization in the Field of Financial Services. The Case of the EU

Effective regulation alone is insufficient, particularly in the context of regulating the access of third-country CRAs and CCPs to the EU. The necessity for legal harmonization is equally imperative in this scenario.

In every developed nation, regulations are introduced with the intention of safeguarding investors within their borders, primarily to enhance the effectiveness of domestic capital markets and, in some cases, to shield the local securities industry from foreign competition.[945]

If jurisdictions do not coordinate and each endorse a unilateral approach, cross-border transactions are subject to multiple regimes. Market players must adhere to all local regulations, and this can create challenges, especially when contradictory rules exist across jurisdictions.[946] For instance, this lack of coordination can lead to a significant lack of certainty regarding which laws are applicable to a transaction involving multiple jurisdictions.

In the context of securities and banking law, where the objective is to unify fragmented markets, an outcome resembling confusion is naturally

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[944] Francesco Pennesi, 'Evaluating the Effectiveness of Equivalence: Towards an Analytical Framework', *Equivalence in Financial Services* (2022).

[945] Lawrence J White, 'International Regulation of Securities Markets: Competition or Harmonization?' in Andrew W. Lo (ed), *The industrial organization and regulation of the securities industry* (National Bureau of Economic Research).

[946] Harald Baum, 'Globalizing Capital Markets and Possible Regulatory Responses' in Toshiyuki Kono and Jürgen Basedow (eds), *Legal Aspects of Globalization, Conflict of Laws, Internet, Capital Markets and Insolvency in a Global Economy* (2000).

deemed unacceptable.[947] Hence, in the case of the EU, the intervention of the European Commission has primarily focused on harmonization at EU and at global level.[948]

When considering CRAs, the concept of harmonization encompasses two distinct areas. Firstly, harmonization can relate to the alignment of activities, liability, competition, and transparency of CRAs, as these aspects constitute the main areas of concern (See Chapter V, Section 1.2.1). Secondly, harmonization also pertains to the standardized use of ratings in capital requirements regulation, as this represents just one of the numerous applications of ratings produced by CRAs. Therefore, harmonization efforts are crucial to ensure consistency and effectiveness both within CRAs' operations and in the broader context of capital requirements regulation.

Regarding the subject of this dissertation - ratings for regulatory purposes - the approaches taken by different regions across the globe have been notably diverse. In particular, there are two distinct and contrasting approaches in their use and, consequently, their regulation. One regulatory approach supports the use of external ratings, while the other approach strictly prohibits their utilization. In this regard, scholars have questioned whether there should be a standardized and coordinated global approach to using ratings in bank capital regulation.[949]

Furthermore, the contrast in regulatory approaches between the EU and the rest of the world, which follows Basel III guidelines has become

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[947] Enriques and Gatti (n 737).
[948] ibid.
[949] Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92); Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225); Periklis Gogas, Theophilos Papadimitriou and Anna Agrapetidou, 'Forecasting Bank Credit Ratings' (2014) 15 Journal of Risk Finance 195.

evident. For instance, in the US, the focus is on reducing or eliminating reliance on external ratings. However, in the EU and other countries adhering to Basel III (excluding the US), external ratings continue to play a significant role in most areas of bank capital regulation, except for rating external securitization exposures.[950] The priority has been to calibrate their use in a manner that aligns with macro-prudential regulatory objectives, while still retaining them for the supplementary information they provide.[951]

On the other hand, the divergent approach to using external ratings in bank capital regulation may pose risks as harmonization at the national, regional, and international levels is essential for implementing international standards aimed at controlling systemic risks that could swiftly spread across borders, potentially damaging other countries' markets.[952] Moreover, achieving a level regulatory playing field through harmonization could enhance competition in global banking markets.

Furthermore, the disparity in requirements concerning the use of external ratings could create opportunities for regulatory arbitrage, where banks may strategically shift their risk-taking to a particular jurisdiction solely to benefit from lower regulatory capital requirements based on the use - or lack thereof - of external ratings in determining capital levels.[953]

In addition, while the EU has made efforts to address governance and competition concerns in the ratings industry through specific reforms, they have not adequately addressed the risks associated with relying heavily on external ratings in calculating bank capital requirements, and

[950] Peter O'Shea, 'Case Studies in Multilevel US-EU Policy Coordination: Credit Ratings Agencies, Accounting Standards and Credit Default Swaps Reform', *Transatlantic Financial Regulation* (2021).
[951] Alexander, 'The Risk of Ratings in Bank Capital Regulation' (n 92).
[952] Hiss and Nagel (n 51).
[953] Chiu (n 223).

the potential financial stability risks involved. The CRA Regulation III adopted in 2013 did not go far enough in addressing these issues and may require further measures to mitigate the potential risks of over-reliance on external ratings in prudential regulation, especially in the context of bank capital regulation.

6.3 The Need for Effective Supervision

Regulators and supervisors primarily concentrated on the micro-prudential supervision of individual financial institutions and did not adequately address the macro-systemic risks arising from interconnected and correlated shocks across the financial system.[954] Additionally, intense global competition among financial centers discouraged national regulators and supervisors from implementing unilateral actions.[955]

Supervision involves overseeing financial institutions to ensure the proper application of rules and standards.[956] Therefore, regulation and supervision are highly interconnected. Furthermore, the effectiveness of any regulatory standard relies heavily on its supervision.[957] Ensuring the consistent implementation of the rules is a crucial aspect of supervision and plays a significant role in maintaining sound balance sheets and a resilient financial system.[958]

Another critical aspect of supervision is managing complexity, innovation, and constant change. In an ever-evolving and intricate financial

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[954] de Larosière and others (n 201).
[955] ibid.
[956] Moloney, 'The European Securities and Markets Authority and Institutional Design for the EU Financial Market - A Tale of Two Competences: Part (1) Rule-Making' (n 236).
[957] Caruana (n 213).
[958] Wymeersch, 'The European Financial Supervisory Authorities or ESAs' (n 667).

landscape, regulations often struggle to keep pace with the rapidly adapting financial sector.[959]

Hence, regulation overseeing third-country CRAs and CCPs must intricately craft a supervisory framework that aligns effortlessly with its intended goals. Specifically, when considering the concept of equivalence in conjunction with EMIR, the aspect of supervision emerges as a particularly contentious component.[960] This stems from the inclusion of a provision that empowers ESMA to exert oversight over companies from third countries, which effectively extends regulatory influence beyond the confines of the EU territory.

6.4 The Need to Safeguard Financial Stability

The EU has taken the position that ensuring financial stability is a top priority when considering the approval or denial of third-country credit rating agencies (CRAs) or CCPs operating within its jurisdiction. Indeed, the European Commission stated that the third country/equivalence regime is primarily oriented towards the EU's financial stability, with market access being a secondary consideration.[961] Hence, the EU's focus on financial stability over market access reflects its commitment to safeguarding its financial system from potential risks and crises that could arise from inadequate or insufficiently regulated CRAs and CCPs. While this approach may be controversial because it may limit market access for some CRAs and CCPs, it is not forbidden under international trade rules.[962] The EU has the authority to set its own standards and

[959] Caruana (n 213).
[960] Weinstein (n 27).
[961] European Commission, 'EU Equivalence Decisions in Financial Services Policy: An Assessment (Commission Staff Working Document) SWD (2017) 102 Final' (n 3); Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323).
[962] George A Papaconstantinou, 'The GATS and Financial Regulation: Time to Clear-House?' (2020) 19 World Trade Review 379.

requirements for and CCPs operating within its borders, as long as these measures are consistent with its obligations under international agreements and do not discriminate unfairly against foreign CRAs and CCPs. While stringent regulations are necessary to maintain financial stability, excessive restrictions could potentially hinder competition and limit access to CRAs and CCPs, which may have adverse effects on market efficiency and innovation.[963] Therefore, regulators need to carefully assess the impact of their regulatory decisions on market dynamics and strive for a balanced approach that achieves both financial stability and market access objectives.

6.5 The Need to Safeguard the Single Market

The harmonization of regulation and supervision of financial services within the EU single market has indeed posed challenges. The EU comprises diverse member states with unique economic structures, financial systems, and regulatory frameworks. Harmonizing these elements to create a level playing field for financial services across the entire EU has been a complex and ongoing process.

While the EU has made significant progress in harmonizing financial regulations through directives, regulations, and frameworks like MiFID II and the Single Rulebook, differences in national interests and priorities can still arise. National regulators and governments may have varying preferences regarding specific rules and regulations, and reconciling these differences to create a unified regulatory framework can be time-consuming and difficult.[964]

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[963] Priem and Girard (n 103).
[964] Hill, 'Regulatory Cooperation in Securities Market Regulation: Perspectives from Australia' (n 326).

Moreover, the process of harmonization may require some member states to give up certain aspects of their regulatory sovereignty, which can be a sensitive issue.[965] As a result, reaching agreements on harmonization measures may involve negotiations, compromises, and considerations of each country's specific circumstances.

Nevertheless, the potential opening of the EU single market further adds complexity to the process of regulation. Publicly opening the single market to additional actors, such as, third countries, can raise concerns about how it may affect existing agreements among member states.[966] It may create new challenges in terms of ensuring consistent and effective implementation of harmonized rules and supervision, as well as addressing potential regulatory gaps or conflicts that may arise with the entry of new participants.[967]

Despite these challenges, the EU recognizes the importance of an open and competitive single market for financial services.[968] An open single market can foster innovation, efficiency, and competition, leading to better services and more choices for consumers. However, it is difficult to keep opening the market and maintaining financial stability and harmonization remains a delicate task for EU policymakers.

7 Conclusion

This chapter has provided an in-depth exploration of various crucial aspects related to the third-country concept within EU law, particularly with a focus on CRAs and CCPs. It has delved into the mechanisms that third countries can use to access the EU market, namely equivalence and

[965] Alexander and Madders (n 535).
[966] Soares (n 772).
[967] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).
[968] Delimatsis (n 237).

endorsement, and has illuminated the challenges and uncertainties associated with these approaches. The roles of ESMA and the European Commission in shaping and determining third-country access have also been thoroughly examined, shedding light on their complex roles in maintaining a delicate balance between stability and openness of the market. The distinctions between access, participation, and the third-country regimes in the EU market have been highlighted, emphasizing the dynamics at play in the regulatory landscape.

Throughout this chapter, the rationale behind the EU legislator's decision to establish these regulations has become increasingly evident. The need for stability, effective regulation, supervision, and safeguarding financial stability and the EU single market has been a driving force in the formulation of these rules. While the instruments and mechanisms put forth by the EU represent significant steps towards harmonization and collaboration with third countries, there are evident issues that require careful attention.

As the EU navigates the complex realm of third-country involvement, it becomes evident that achieving a harmonious and effective regulatory framework is not without its challenges. The chapter underlines the necessity for continual refinement and adaptation in order to meet the evolving needs of the financial sector and promote global financial stability. Furthermore, the consideration of the impact on third countries' legislation is of paramount importance in the formulation of instruments aimed at facilitating CRAs and CCPs' access to the EU single market. This is particularly crucial given that these instruments may exert implications on the internal legal frameworks of third countries. By grappling with these multifaceted issues and fostering an environment of constructive dialogue and cooperation, the EU endeavors to achieve a balance that

safeguards its interests while promoting shared prosperity and financial stability in the international financial arena.

PART III: PRACTICAL FRAMEWORK

CHAPTER VII INSIGHTS FROM CASE STUDIES ON AUSTRALIAN CRAs AND UK CCPs

Within the dynamic landscape of international finance, this chapter delves into two compelling case studies that illustrate the complex relationship between third-country regimes and the global reach of EU law. The objective of this exploration is to provide a comprehensive understanding of the challenges, intricacies, and outcomes associated with third-country interactions in the context of CRAs and CCPs within the EU.

The case studies that anchor this chapter are two-fold. The first case study unravels the narrative of an equivalence decision pertaining to CRAs in Australia. This decision, initially granted and subsequently withdrawn, serves as an example of the potential and limitations of equivalence decisions and endorsement. The section will begin by setting the stage, presenting the position of Australia as a third country vis-à-vis the EU. Subsequently, the circumstances leading to the withdrawal of the equivalence decision for Australian CRAs will be expounded, examining the decision-making processes that shaped this outcome. Then, the response of Australia, characterized by its decision not to alter its domestic legislation to regain equivalence, will be scrutinized. This response will underscore Australia's resilience in navigating the financial services landscape, both during and after the global financial crisis. The analysis will culminate in an observation of how territorial extension, the global reach of EU law, and the Brussels effect intersect and manifest within this case.

Shifting focus, the exploration will transition to the second case study, centered around the equivalence decisions concerning CCPs in the UK after Brexit. To comprehensively examine this case, it is imperative to

grasp the transformed status of the UK as a third country. The backdrop of equivalence decisions will be presented, unraveling the particulars of how these decisions were formulated and the peculiarities associated with them in the UK context. One distinctive feature of this case is the introduction of Tier 2 CCPs by the EU, necessitating a new regulatory instrument called comparable compliance to complement equivalence. The implications of these transformations for the UK will be explored, highlighting their consequences in the evolving financial landscape. As the analysis unfolds, the examination will extend to encompass the global reach of EU law, viewed through the lenses of both territorial extension and extraterritoriality.

In conclusion, this chapter attempts to show the complex landscape of third-country regimes and the far-reaching impact of EU law in the field of financial services concerning CRAs and CCPs. Through the prism of the Australian CRAs and UK CCPs case studies, it aims to provide a holistic perspective on how the EU navigates and shapes its financial interactions with third countries. As these cases illuminate the complexities of regulatory convergence, divergence, and cooperation, they offer invaluable insights into the challenges and opportunities inherent in the global financial landscape.

1 Literature Review

As a response to the gaps in the existing body of knowledge concerning instruments available to grant market access to financial services providers from third countries in the EU, this research has undertaken a comprehensive exploration, delving into the intricate interplay between equivalence and endorsement as third-country regimes for CRAs and CCPs. To illustrate the practical implications of these regulatory mechanisms, this study has examined specific cases such as the

withdrawal of an equivalence decision in Australia and the more recent adoption of an equivalence decision concerning UK CCPs.

The withdrawal of equivalence to Australian CRAs has served as a prominent example highlighting the potential significance of equivalence decisions within the EU. Scholars have indeed cited the Australian case in discussions surrounding equivalence decisions; however, the primary focus has often been on exploring the broader implications for the EU and its regulatory framework, rather than delving into the direct impact on Australia.[969] The Australian situation serves as an illustration of the multifaceted aspects of equivalence decisions.

On the other hand, scholars in Australia have conducted comprehensive research that extensively examines the remarkable resilience of the country's financial system during the global financial crisis and the economic relations between the EU and Australia[970]. This body of work is highly valuable to the present research, given that the concept of equivalence emerged as a regulatory response to the financial crisis.[971] Therefore, studying equivalence decisions within a context where the

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[969] Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11); Baur (n 321); García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241); Moloney, 'Capital Markets Union, Third Countries, and Equivalence. Law, Markets, and Brexit' (n 53).

[970] Jennifer G Hill, 'Why Did Australia Fare so Well in the Global Financial Crisis?' in Eilís Ferran and others (eds), *The Regulatory Aftermath of the Global Financial Crisis* (2nd edn, Cambridge University Press 2013); Mohamed Ariff, John Farrar and Ahmed M Khalid, *Regulatory Failure and the Global Financial Crisis: An Australian Perspective*; Carl Schwartz, 'G20 Financial Regulatory Reforms and Australia' (2013) September Quarter; Margherita Matera and Philomena Murray, 'Australia's Relationship with the European Union: From Conflict to Cooperation' (2018) 72 Australian Journal of International Affairs 179; Annmarie Elijah, 'Better the Devil You Know? Australia and the British Bids for European Community Membership' (University of Melbourne 2004); Gonzalo Villalta Puig, 'Drivers and Difficulties in the Economic Relationship between Australia and the European Union: From Conflict to Cooperation' (2018) 72 Australian Journal of International Affairs 240; Hill, 'Regulatory Cooperation in Securities Market Regulation: Perspectives from Australia' (n 326).

[971] Quaglia, 'The Politics of "Third Country Equivalence" in Post-Crisis Financial Services Regulation in The European Union' (n 53).

crisis had a relatively lesser impact compared to other regions, provides a unique and insightful perspective.

Furthermore, scholars such as Moloney and Wymeersch have diligently delved into the ramifications of equivalence decisions.[972] Their insightful analyses provide valuable insights into the multifaceted implications of such decisions on the involved parties and the broader regulatory landscape.

Following the withdrawal of equivalence, the option of endorsement remains open for Australian CRAs to seek EU recognition for their credit ratings. Endorsement has been studied by scholars such as García-Alcubilla, Ruiz-del Pozo and Deipenbrock since it is a unique alternative for third-country CRAs to prove that their credit rating activities comply with EU standards.[973] Both equivalence and endorsement mechanisms reveal elements that indicate the territorial extension of EU law, especially in the field of credit rating agencies.[974] These mechanisms involve assessing the regulatory frameworks of third countries, which inevitably involves interactions beyond the EU's geographical boundaries. As a result, these actions exemplify the territorial reach of EU regulatory practices, extending the influence of EU norms to non-member states.[975] This interconnectedness and the "Brussels Effect" are essential components of the EU's role in shaping the global financial landscape.[976]

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[972] Moloney, 'Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit' (n 323); Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (n 11).
[973] García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241); Deipenbrock, 'Trying or Failing Better Next Time? - The European Legal Framework for Credit Rating Agencies after Its Second Reform' (n 225).
[974] Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32).
[975] Bradford, 'How the EU Became a Global Regulatory Power?' (n 237).
[976] Bradford, 'The Brussels Effect: How the European Union Rules the World' (n 36).

Concerning the UK CCPs' case, the UK's transition from an EU member state to a third country has instigated a wave of research to analyze the repercussions of this shift in various sectors, including the financial services industry.[977] Particularly, CCPs and their relationship with the EU has garnered considerable attention from scholars, yielding insights into the complex dynamics of this transition.[978]

One of the fundamental aspects explored in the literature is the impact of the UK's third-country status on CCPs and their regulatory framework. As early as the Brexit referendum in 2016, researchers such as James, Quaglia and Ferran predicted potential challenges that could arise due to the loss of the EU financial passport, which enabled UK-based CCPs to operate seamlessly across EU member states.[979] This prompted a thorough examination of alternative mechanisms to ensure continued access to EU markets.[980]

On the other hand, comparable compliance, as described in EMIR 2.2 and the Commission Delegated Regulation 2020/1304, has been scrutinized for its effectiveness in balancing regulatory autonomy with cross-border financial stability and the imposed burden on ESMA which is in charge of it.[981] Notably, ESMA stated that it does not have the tools to evaluate it

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[977] Berger and Badenhoop (n 590); Wessel (n 244); Pitz and Nemeczek (n 774); Niamh Moloney, 'EU Financial Governance after Brexit: The Rise of Technocracy and the Absorption of the UK's Withdrawal.' in Kern Alexander and others (eds), *Brexit and financial services—law and policy* (Bloomsbury 2018); Arner (n 200); Ferrarini and Saguato (n 120); Morrison (n 259).

[978] James and Quaglia, 'Controversies Over Clearing: Regulation of Derivatives' (n 778); James and Quaglia, 'Brexit and the Political Economy of Euro-Denominated Clearing' (n 774); Dermot Turing, 'Clearing Away after Brexit?' 9 Journal of Financial Market Infrastructures 3 2020; Braithwaite (n 45).

[979] James and Quaglia, '9 Brexit and the Future UK – EU Relationship' (n 240); Ferran, 'The UK as a Third Country Actor in EU Financial Services Regulation' (n 26).

[980] Lannoo (n 787); Wymeersch, 'Brexit and the Equivalence of Regulation and Supervision' (n 777); Kalaitzake (n 243).

[981] Lehmann, 'CCP Supervision After Brexit: From Extraterritoriality to a Model of Shared Control' (n 108); Niamh Moloney, 'Third Countries and EU Financial Market Access:

properly.[982] Moreover, the challenges associated with equivalence have not been overlooked in the field of CCPs. Broader negotiations between the EU and the UK have created uncertainties that extend to the financial services sector.[983]

Amid these discussions, the potential role of comparable compliance as a complementary mechanism to equivalence has also been explored. In this regard, Klaus Löber, the chair of the CCP Supervisory Committee at ESMA, delved into the unique characteristics of comparable compliance, considering its potential to offer additional safeguards in the oversight of systematically important CCPs, while acknowledging its extraterritorial implications on third-country regulations.[984]

As a result, the literature on the UK's status as a third country for the EU and its implications for CCPs is extensive and multifaceted. From examining the intricacies of equivalence and comparable compliance mechanisms to evaluating the evolving regulatory landscape, scholars continue to contribute to the understanding of how the UK's new position impacts the financial services ecosystem and its interactions with the European Union.

Given the nuanced yet interconnected nature of CRAs and CCPs, they have been selected as focal points for this research. Both fields have been extensively examined in the existing literature, yet certain dimensions pertaining to the far-reaching consequences of endorsement and equivalence for third countries and the broader global financial landscape remain underexplored. By analyzing real-world instances such as the case

Technocracy, Politics, and the End of Deference?' in Jaeger T Lehmann, A M. Somek and M Waibel (eds), *Consolidating Brexit* (Verlag Publishing 2023).

[982] European Securities and Markets Authority (ESMA), 'Assessment Report under Article 25(2c) of EMIR. Assessment of LCH Ltd and ICE Clear Europe Ltd. Part 2'.

[983] Leruth, Gänzle and Trondal (n 244); Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (n 317).

[984] Löber (n 28).

of Australian CRAs and UK CCPs, this research aims to shed light on the multifaceted dynamics and consequences of equivalence and endorsement within the context of evolving global financial frameworks.

2 Case Study 1: Equivalence Withdrawal and Endorsement for Australian Credit Ratings

An equivalence decision taken in 2012 which had deemed equivalent the regulation and supervision of the Australian CRAs was repealed in 2019 by the European Commission.[985] Furthermore, before obtaining equivalence, the Australian Securities and Investment Commission (ASIC) had already developed a guide on some Australian financial services based on the standards of the International Organization of Securities Commissions (IOSCO) and the European Securities and Markets Authority (ESMA).[986] The equivalence decision was repealed as, in 2013, the EU updated its legal framework of CRAs through Regulation (EU) No. 462/2013, adding new requirements to EU registered agencies, and the Australian authorities did not update their legislation to include these new requirements or to have similar effects.[987] Hence, the European Commission, on advice from the ESMA, concluded that the Australian supervisory and regulatory regime on CRAs did not fulfil the equivalence

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[985] Commission Implementing Decision (EU) 2019/1276 of 29 July 2019 repealing Commission Implementing Decision 2012/627/EU on the recognition of the legal and supervisory framework of Australia as equivalent to the requirements of Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies, *OJ* [2019] L 201/17, 30.7.2019.

[986] Australian Securities and Investment Commission (ASIC), 'Credit rating agencies - guidance on certain AFS licence conditions', Guidance on certain AFS licence conditions (2011), available at: <https://asic.gov.au/regulatory-resources/financial-services/credit-rating-agencies/credit-rating-agencies-guidance-on-certain-afs-licence-conditions/> accessed 28 November 2023.

[987] Regulation (EU) No. 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies, *OJ* [2013] L 146/1, 31.5.2013.

conditions.[988] Therefore, if the Australian authorities wanted to re-establish such equivalence, they would have to modify or add new legal provisions based on Regulation (EU) No. 462/2013. For this reason, this research illustrates that equivalence decisions and endorsement have contributed to the global reach of EU law in financial legislation through territorial extension and extraterritoriality.

2.1 Navigating Australia's Status as a Third Country in EU Context

Australia falls under the category of a third country, which in the third countries' categories of Chapter III is classified as a country distant from the EU with lower impact in the EU's single market. In fact, Australia lacks a specific bilateral agreement with the EU regarding financial services. Nonetheless, due to both Australia and the EU being WTO members, the framework governing the provision of financial services between them is rooted in the General Agreement on Trade in Services (GATS).

Throughout history, the Australia-EU economic relationship has encountered numerous obstacles, with trade politics often straining the broader terms of the bilateral ties.[989] Therefore, it is important to acknowledge that decades ago, the prospect of a trade agreement between the two seemed highly unlikely. Australian policymakers faced what seemed like insurmountable difficulties, and from the perspective of

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[988] European Commission, 'Commission sets out its equivalence policy with non-EU countries and presents its recent EU equivalence decisions', Press Release (29 July 2019), <https://ec.europa.eu/commission/presscorner/detail/en/ip_19_4309> accessed 28 November 2023.

[989] Andrea Benvenuti, *Anglo-Australian Relations and the 'Turn to Europe'*; Donald Kenyon and David Lee, *The Struggle for Trade Liberalization in Agriculture: Australia and the Cairns Group in the Uruguay Round* (2006); Elijah (n 970); Philomena Murray, Annmarie Elijah and Carolyn O'Brien, 'Common Ground, Worlds Apart: The Development of Australia's Relationship with the European Union' (2002) 56 Australian Journal of International Affairs 395.

European policymakers, there was no evident reason to initiate negotiations with Australia.[990]

However, a significant turning point occurred in 2018 when the Council of the European Union granted the approval for commencing negotiations on a Free Trade Agreement (FTA) between the EU and Australia on 22 May 2018. Prior to this decision, the Commission had conducted an Impact Assessment to assess the potential consequences of the upcoming FTAs with Australia1 and New Zealand.

However, as is customary, there have not been negotiations pertaining to financial services.[991] It remains uncertain whether any such provisions will be included. Consequently, up until the current equivalence decision that is the focus of this case study, the interaction of financial services between the EU and Australia has been regulated by the EU's third-country framework, which is also encompassed by the World Trade Organization (WTO),[992] and CRA Regulation which involves the concepts of equivalence and endorsement, specifically concerning CRAs.[993]

2.2 Background on Equivalence Decision to Australian CRAs

2.2.1 Brief Explanation of the First Equivalence Decision

On November 17, 2009, the European Commission requested CESR's advice on the technical evaluation of Australia's legal and supervisory

[990] Annmarie Elijah and others, 'Australia, the European Union and the New Trade Agenda', *Australia, the European Union and the New Trade Agenda* (Australia National University (ANU) Press).
[991] European Commission, 'European Commission Services' Position Paper on the Sustainability Impact Assessment in Support of Negotiations for the Free Trade Agreement between the European Union and Australian' (2021).
[992] Recital 7 Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L 201/1 (EMIR Regulation) (n 5).
[993] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1 (CRA Regulation I) (n 58).

framework concerning credit rating agencies. It was not until 2012, after the establishment of ESMA, that a significant development occurred. On April 18, 2012, ESMA issued a recommendation, suggesting that the Australian legal and supervisory system concerning CRAs should be recognized as equivalent to CRA Regulation I.

2.2.2 Key Factors that led to the Initial Equivalence Recognition

As per the second paragraph of Article 5(6) of CRA Regulation I, the evaluation of three conditions is required to determine if a third country's legal and supervisory framework is equivalent to CRA Regulation I:

-The first condition stipulates that CRA operating in the third country must undergo authorization or registration and be subjected to continuous effective supervision and enforcement. The Australian legal framework for CRAs came into effect on January 1, 2010. Hence, all applicable laws, such as the Corporations Act (2001) and the Australian Securities and Investments Commission (ASIC) Act (2001), were in operation.

Under this regulatory framework, credit rating agencies are required to undergo registration and are subject to continuous supervision by the Australian Securities and Investments Commission (ASIC). The Australian legal and supervisory system grants ASIC adequate authority to ensure effective supervision and enforcement of credit rating agencies. This includes the power to sanction CRAs that violate the relevant regulations, and ASIC is authorized to confiscate documents not provided by CRAs. Under the authority of a search warrant issued by the appropriate judicial body, ASIC possesses the ability to conduct searches of credit rating agency premises. Moreover, as per the Corporations Act, ASIC is authorized to approach a federal court to seek orders for the revocation of a credit rating agency's license. After the license is canceled, ASIC has the authority to seek court orders to permanently prevent the CRA from

issuing credit ratings in Australia. Additionally, under the Corporations Act, ASIC can seek orders to halt any unlawful conduct by a CRA or impose fines if the agency violates its obligations under financial services legislation. The cooperation agreement between ESMA and ASIC allows for the exchange of information related to enforcement and supervisory actions taken against cross-border CRAs.

-As per the second requirement, credit rating agencies in the third country must adhere to legally binding rules that are on par with those outlined in Articles 6 to 12 and Annex I of CRA Regulation I. The Australian legal and supervisory system fulfills the aims of the EU regulatory framework concerning CRAs' management of conflicts of interest. The Australian legislation (ASIC Act) mandates the handling of conflicts of interest and enforces organizational requirements, particularly pertaining to outsourcing, record keeping, and confidentiality. Regarding corporate governance, the ASIC's licensing conditions demand that a credit rating agency is structured in a way that safeguards the independence and accuracy of its credit rating activities, ensuring its business interests do not compromise these aspects. The Australian framework also mandated credit rating agencies to establish a robust review function for rating methodologies and included comprehensive disclosure requirements concerning credit ratings and rating activities.

Hence, the Australian legal and supervisory framework aligns with the goals of CRA Regulation I concerning the management of conflicts of interest, the organizational requirements and procedures expected from a CRA, the quality of ratings and rating methodologies, as well as the disclosure of credit ratings and related activities. As a result, it ensures comparable protection in terms of integrity, transparency, good governance of credit rating agencies, and the reliability of credit rating activities.

-The third condition requires that the regulatory system in the third country must prohibit any intervention by supervisory authorities or other public entities in the content of credit ratings and methodologies. In the case of Australia, such interference would run counter to the objectives outlined in Chapter 7 of the Corporations Act of 2001 and ASIC's own objectives. Both ASIC and other public authorities lack the authority to intervene in the content of credit ratings or rating methodologies.

Based on the factors assessed, the European Commission in accordance with the European Securities Committee's opinion concluded that the requirements set out in the second subparagraph of Article 5(6) of CRA Regulation I have been fulfilled by the Australian legal and supervisory framework for CRAs. Hence, the Australian legal and supervisory framework for CRAs should be deemed equivalent to the framework established by CRA Regulation I.

In its advisory statement issued on April 18, 2012, ESMA proposed that the legal and supervisory framework pertaining to credit rating agencies in Australia should be regarded as comparable to CRA Regulation I.

The European Commission, in collaboration with ESMA, would continuously monitor the developments in the Australian legal and supervisory framework for credit rating agencies, ensuring that the conditions on which this decision is based continue to be met.

2.3 Changes in the EU Regulatory Landscape

2.3.1 Overview of the EU Regulatory Changes Impacting CRAs

The CRA Regulation III reforms aimed to tackle inherent weaknesses in the market structure that were not solved before. The European Commission's Impact Assessment emphasized a range of persistent issues in the CRA market that had not been resolved by previous

reforms.[994] Relying excessively on ratings for regulation, risk management, and investment strategies, as well as lacking sufficient information on structured-finance ratings, contributed to market pro-cyclicality.[995] On the other hand, the high concentration of CRAs, along with entry barriers and a lack of ratings comparability, restricted choices and competition; hence, users of ratings had limited recourse for grievances, and conflict-of-interest risks, particularly related to ownership structures, remained inadequately addressed.[996]

2.3.2 The 2013 Amendment and its Implications for Equivalence Recognition

The European Commission considered that the Australian legal and supervisory framework continued to satisfy the initial three conditions specified in Article 5(6) of CRA Regulation I.

However, it is essential to consider that the amendment introduced by the CRA Regulation III (Regulation (EU) No 462/2013) added obligations for CRAs registered in the EU, imposing more stringent requirements on their legal and supervisory regime.[997] These additional obligations encompass aspects such as rating outlooks, conflicts of interest management, confidentiality standards, rating methodology quality, and the disclosure and presentation of credit ratings.[998]

[994] European Commission, 'Commission Staff Working Document Paper. Impact Assessment Accompanying the Document Proposal for a Regulation Amending Regulation (EC) No 1060/2009 on Credit Rating Agencies and a Proposal for a Directive Amending Directive 2009/65/EC on coordination on laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Directive 2011/61/EU on Alternative Investment Fund Managers' (n 382).
[995] Moloney, 'Gatekeeper Regulation and the EU' (n 68).
[996] Quaglia, 'The EU and Global Securities Markets Regulation' (n 719).
[997] Commission Implementing Decision (EU) 2019/1276 of 29 July 2019 repealing Commission Implementing Decision 2012/627/EU on the recognition of the legal and supervisory framework of Australia as equivalent [2019] L 201/17 (n 25).
[998] ibid.

In particular, section (1)(b) of the second paragraph of Article 2 of CRA Regulation III, the supplementary requirements were taken into account when evaluating the equivalence of third-country legal and supervisory frameworks starting from 1 June 2018.

2.3.3 Communication from the European Commission Regarding Compliance with the New Regulatory Framework

In light of this context, on 13 July 2017, the Commission sought guidance from the European Securities and Markets Authority (ESMA) concerning the comparability of the legal and supervisory system of Australia, among others, with the supplementary requirements introduced by Regulation (EU) No 462/2013. ESMA's advice was also sought to evaluate the significance of any disparities between the two frameworks.[999] As a consequence, ESMA determined in its technical advice issued on 17 November 2017 that the Australian legal and supervisory framework lacks adequate provisions to fulfill the objectives of the supplementary requirements established by CRA Regulation III.[1000]

After evaluating the relevant factors, the European Commission concluded that the Australian legal and supervisory framework for CRAs does not meet all the requirements for equivalence as stated in the second subparagraph of Article 5(6) of CRA Regulation I. Consequently, it was not regarded as equivalent to the legal and supervisory framework established by the said Regulation. As a result, Implementing Decision 2012/627/EU was revoked.

[999] ibid.

[1000] European Securities and Markets Authority (ESMA), 'Final Report. Technical Advice on CRA Regulatory Equivalence – CRA 3 Update' (n 383).

2.4 Failure to Adapt to New EU Regulations

2.4.2 Analysis of the Response (or Lack Thereof) from Australian CRAs to Comply with the 2013 Amendment

The Communication highlighted the main differences between the Australian framework and the EU framework. In particular, it referred to the following aspects:

1-Article 3(1)(w) that introduced a new definition for "rating outlook" and extended certain requirements applicable to credit ratings to include rating outlooks under CRA Regulation I. Although the Australian legal and supervisory framework does not explicitly mention rating outlooks, the ASIC deems them to be covered under the definition of "financial product advice," thus subjecting them to similar requirements as credit ratings.

2-In order to strengthen the perception of credit rating agencies' independence from the entities they rate, CRA Regulation III extends the rules on conflicts of interest to include conflicts arising from significant shareholders or members within the CRA, as stated in Article 6(4), 6a, and 6b of CRA Regulation I. While the Australian legal and supervisory framework requires CRAs to have adequate measures in place to manage conflicts of interest, it does not explicitly address conflicts related to shareholders. As a result, there are no similar requirements in place to prevent a CRA from issuing credit ratings on entities holding more than 10% of its shareholding or providing advisory services to entities holding more than 5% of its shareholding.

3-CRA Regulation III introduced new provisions aimed at ensuring the appropriate use and safeguarding of confidential information in credit rating activities. Article 10(2a) of CRA Regulation I mandates CRAs to treat all credit ratings, rating outlooks, and associated information as

inside information until the moment of disclosure. The Australian legal and supervisory framework outlines specific requirements that CRAs must adhere to in order to protect confidential information related to issuers. Consequently, there exists a reliable framework to prevent the misuse of confidential information.

4-CRA Regulation I aims to enhance transparency and the quality of rating methodologies. One of the changes introduced is the obligation for CRAs to give a rated entity the chance to point out any factual errors before publishing the credit rating or rating outlook, as stated in Annex I, Section D, Subsection I paragraph 3 of Regulation I. However, the Australian legal and supervisory framework does not explicitly require CRAs to inform rated entities about credit ratings prior to publication. Instead, the Australian framework allows for CRA notification to a rated entity only when it is considered "feasible and appropriate," without specifying a minimum response time.

5-CRA Regulation III implements safeguards in Article 8(5a), (6) aa, and (ab), and (7) of CRA Regulation I to ensure that modifications to rating methodologies do not lead to less rigorous methodologies. Under the Australian legal and supervisory framework, rated entities affected by methodology changes must be informed. However, there is no requirement for CRAs to consult with market participants before making significant changes to methodologies, inform the supervisor, or disclose identified errors in a rating methodology on the CRA's website.

6-CRA Regulation III strengthened the requirements concerning the presentation and disclosure of credit ratings. According to Article 8(2) and Annex I, Section D, Subsection I, paragraph 2a of CRA Regulation I, a CRA must provide clear and easily understandable guidance, accompanying the disclosure of rating methodologies, models, and key

rating assumptions. This guidance should explain the assumptions, parameters, limits, and uncertainties related to the models and rating methodologies used in the credit rating process. However, under the Australian legal and supervisory framework, while CRAs are obligated to disclose whether a credit rating was solicited and if the rated entity participated, as well as provide information on any limitations of credit ratings, there is no requirement to offer such guidance to the public regarding the methodology behind a credit rating.

7-CRA Regulation III aims to enhance competition and reduce conflicts of interest in the CRA sector. To achieve this, it introduces a requirement in Annex I, Section E, Subsection II of CRA Regulation I that fees charged by CRAs for credit ratings and ancillary services must be non-discriminatory and based on actual costs. The regulation also mandates CRAs to disclose specific financial information. On the other hand, the Australian legal and supervisory framework obliges CRAs to disclose revenue streams to the public and certain information to the supervisor through an annual report, excluding small CRAs. However, there are no requirements for CRAs to publicly disclose preliminary ratings or report their fee schedules or fees charged to clients to the supervisor. Furthermore, there is no stipulation that fees charged to clients should be cost-based and non-discriminatory.

2.4.3 European Commission's Decision to Withdraw Equivalence

In 2019, the European Commission repealed not only the Equivalence Certification on Australian CRAs but several equivalence decisions under the rating agency regime.[1001] Indeed, the decision to revoke several

[1001] Canada Commission Implementing Decision (EU) 2019/1277 of 29 July 2019 repealing Implementing Decision 2012/630/EU on the recognition of the legal and supervisory framework of Canada as equivalent to the requirements of Regulation (EC)

equivalence decisions, including the Equivalence Certification for Australian Credit Rating Agencies, was rooted in the same underlying reason: certain jurisdictions had not kept pace with the necessary updates to their regulatory frameworks following the subsequent reforms to CRA Regulation I.[1002] The process of withdrawal was relatively uncontroversial and not subjected to significant political debate.[1003] The affected third countries had engaged in discussions with the Commission and ESMA regarding the impact of the reforms but they ultimately chose not to implement the necessary changes, considering the limited extent of their rating activities related to the EU.[1004] Additionally, the existence of the endorsement regime provided an alternative pathway for these countries to access the EU market.[1005]

2.5 Analysis From the Australian Perspective

The Australian authorities decided not to modify their internal legislation, considering that the potential activities they could undertake in the EU

No 1060/2009 of the Europe (n 882); Argentina Commission Implementing Decision (EU) 2019/1282 of 29 July 2019 repealing Implementing Decision 2014/246/EU on the recognition of the legal and supervisory framework of Argentina as equivalent to the requirements of Regulation (EC) No 1060/2009 of the Eur (n 882); Brazil Commission Implementing Decision (EU) 2019/1281 of 29 July 2019 repealing Implementing Decision 2014/245/EU on the recognition of the legal and supervisory framework of Brazil as equivalent to the requirements of Regulation (EC) No 1060/2009 of the Europe (n 882); Singapore Commission Implementing Decision (EU) 2019/1278 of 29 July 2019 repealing Implementing Decision 2014/248/EU (n 882).

[1002] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Equivalence in the Area of Financial Services' (n 844).

[1003] However, these decisions highlighted the conditional nature of equivalence and occurred during a sensitive period in the UK's withdrawal process from the EU. Hence, the repeal met some apprehension in the UK. Jim Brunsden, 'EU Decision on Equivalence Set to Heighten UK Post-Brexit Fears' *Financial Times* (Brussels, 2019).

[1004] Moloney, 'Third Countries and EU Financial Market Access: Technocracy, Politics, and the End of Deference?' (n 981).

[1005] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13).

market were limited.[1006] Therefore, making significant changes to their laws would outweigh the benefits they could receive from increased access to the EU market. [1007]However, the possibility of endorsement remained open, allowing credit ratings from Australian CRAs to be endorsed by EU CRAs. This is because, unlike equivalence, Australia is among the countries authorized for endorsement, meaning that ratings from Australian CRAs could still be recognized and utilized in the EU market under the endorsement mechanism. Endorsement provides an alternative path for Australian CRAs to operate within the EU financial services sector without requiring substantial changes to their domestic regulatory framework.

On the other hand, after the loss of equivalence, the changes in the Australian Financial Market were relatively inconspicuous as the country chose not to alter its existing laws. However, the Australian regime is built upon the IOSCO Code, which indicates that it adheres to a high standard for the Credit Rating industry. At present, the regulation in Australia includes specific elements from the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, and credit rating agencies are mandated to integrate these provisions into their Australian financial services license conditions, with necessary modifications. This approach ensures that the Australian Credit Rating industry operates in line with international best practices and standards.[1008]

[1006] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Equivalence in the Area of Financial Services' (n 844).
[1007] Brunsden (n 1003).
[1008] Australian Securities and Investment Commission (ASIC) (n 986).

2.5.1 Australia's Performance During the Global Crisis

Australia experienced a relatively milder impact from the financial crisis in 2007-8 compared to certain other nations.[1009] Despite not being entirely flawless, Australia's financial system demonstrated commendable resilience.[1010] This can be attributed to the overall prudent management of most institutions and a strong supervisory framework. Nevertheless, the crisis did provide valuable insights for Australia, and its regulatory authorities have diligently considered these lessons along with the global reform measures that emerged in response to the crisis.[1011]

For example, the Australian Prudential Regulation Authority (APRA) completed the formulation of its prudential standards for implementing the Basel III capital standards (international standards related to credit ratings for regulatory purposes) in late 2012.[1012] Moreover, Australia, along with 10 other jurisdictions, officially adopted the capital components of Basel III starting from 1 January of 2013,[1013] while some significant jurisdictions, especially the EU and the US, were slightly behind in the implementation process, although all member jurisdictions of the BCBS (Basel Committee on Banking Supervision) had released draft regulations by mid-February.[1014] Hence, Australia was regarded as an "early adopter" of the Basel III reforms because it imposed compliance with several primary capital measures two or three years ahead of the extensive

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[1009] Glenn Stevens, 'Financial Regulation – Australia in the Global Landscape' 1.
[1010] Hill, 'Why Did Australia Fare so Well in the Global Financial Crisis?' (n 970).
[1011] Stevens (n 1009).
[1012] Australian Prudential Regulation Authority (APRA), Response to Submissions II Implementing Basel III capital reforms in Australia 2012.
[1013] Australian Prudential Regulation Authority (APRA), 'Prudential Standard GPS 001 Definitions'.
[1014] Basel Committee on Banking Supervision (BCBS), 'Regulatory Consistency Assessment Programme (RCAP) - Assessment of Basel III Regulations- Australia' (2014).

schedule stipulated in Basel III.[1015] Furthermore, APRA did not use the flexibility offered by Basel III to grant lenient treatment for specific items when calculating regulatory capital. By contrast, it was stricter on certain areas.[1016]

These facts show how Australia's financial regulation deserves commendation for its diligent adherence to established international standards, accomplishing this well within the expected timeframe and even ahead of schedule. Moreover, its relative resilience to market disruptions compared to other states is noteworthy. The sensitivity of this situation arises from the potential impact of any modification in its regulations aimed at aligning with EU standards, which could alter the observed outcomes. In fact, Australia did not modify its legislation on CRAs. However, this situation underscores the complexity of extraterritorial reach, particularly in the realm of financial services. In contrast to areas like GDPR or competition law, financial services revolve primarily around maintaining financial stability and mitigating systemic risk.

In this instance, Australia's lack of involvement in the EU's credit ratings and absence of significant trade relations at stake provided the freedom to reject the proposed modifications necessary to implement the new requirements established by CRA Regulation III. However, this scenario prompts us to consider the potential outcomes in a different context. As a result, it becomes clear that not all measures can have a uniform impact or produce identical results when applied to every third country in such complex matters.

[1015] Stevens (n 1009).
[1016] Basel Committee on Banking Supervision (BCBS) (n 1014).

2.5.2 Navigating the Consequences: Endorsement as a Continuing Option through a Memorandum of Understanding for Australian Credit Ratings

The Australian Securities and Investments Commission (ASIC) and the ESMA, who are responsible for supervising CRAs in their perspective jurisdictions had recognized, in light of the cross-border activities of certain CRAs and the global nature of ratings generally, the importance of ongoing supervisory and enforcement-related cooperation in this area. Consequently, these institutions signed a Memorandum of Understanding in 2011 to cooperate and follow CRA Regulation I which had introduced endorsement and equivalence certification mechanisms for credit rating agencies established outside the EU.[1017] As a result, with the withdrawal of the equivalence option, the endorsement route became the sole mechanism available for the regulatory recognition of Australia's credit ratings within the EU's regulatory framework.

2.6 Expanding the Global Reach of EU Law: Exploring Endorsement, Equivalence, and Territorial Extension through the Australian Case

Conversely, as elucidated in Chapter VI, a conundrum emerges regarding the interpretation of the endorsement regime, and this is attributed to Recital 13 within CRA Regulation I:

"When endorsing a credit rating issued in a third country, credit rating agencies should determine and monitor, on an ongoing basis, whether <u>*credit rating activities*</u> *resulting in the issuing of such a credit rating comply with requirements for the issuing of credit ratings which are as*

[1017] European Securities and Markets Authority (ESMA), 'Memorandum of Understanding on the Cooperation of Competent Authorities for the Supervision of the CRAs' (2011).

stringent as those provided for in this Regulation, achieving the same objective and effects in practice."

Certain scholars suggest that the term "third-country credit rating activities" (highlighted in the preceding text) pertains to the legislation of the third country,[1018] while contrasting viewpoints, including those of other authors and a clarification from ESMA in a report,[1019] contend that it specifically pertains to the conduct of third-country CRAs. Adopting this distinction serves as a valuable means to delineate this mechanism from the concept of equivalence.

In the context of the scope of this research, this dilemma assumes added significance as it serves to point out the global reach of EU law in this specific case. In alignment with this, Scott appropriately explains that: *"a measure will be regarded as giving rise to territorial extension when its application depends upon the existence of a relevant territorial connection, but where the relevant regulatory determination will be shaped as a matter of law, by conduct or circumstances abroad".*[1020]

This notion is particularly evident when considering the case of CRAs, where all the elements of territorial extension come into play in both endorsement (Article 4(3) CRA Regulation I) and equivalence (Article 5 CRA Regulation I) scenarios, which will be tested in the following section.

[1018] Moloney, 'Gatekeeper Regulation and the EU' (n 68).
[1019] European Securities and Markets Authority (ESMA), 'Guidelines On the Application of the Endorsement Regime under Article 4(3) of the Credit Rating Agencies Regulation (20/05/2019) ESMA33-9-282' (n 13); García-Alcubilla and Ruiz-del Pozo, 'Use of Non-EU Ratings in the EU' (n 241).
[1020] Scott, 'Extraterritoriality and Territorial Extension in EU Law' (n 32).

2.7 Testing Territorial Extension: An Analysis of Endorsement and Equivalence of CRAs

This examination will involve dissecting various components of Scott's definition of territorial extension and applying them to the context of endorsement and equivalence in the case of CRAs. Through this analysis, we aim to discern how these mechanisms work and whether they align with the concept of territorial extension as proposed by Scott.

1. A Relevant Territorial Connection:

CRAs from a third country are capable of providing credit ratings to the EU.

2. Regulatory Determination Shaped as a Matter of Law:

An implementing decision of the EU, carried out by the European Commission or the ESMA (in the case of endorsement), determines whether endorsement and equivalence are granted. If approved, these agencies' ratings can operate; if not, or if the decision is subsequently withdrawn, the third country's recourse is to update its regulations to align with EU standards.

3. Conduct or Circumstances Abroad:

This aspect presents two perspectives depending on the type of instrument used: equivalence or endorsement. In the former, the analysis of third-country regulatory and supervisory frameworks becomes the decisive factor in granting equivalence. Hence, the regulatory *circumstances abroad* dictate the decision. In the latter scenario, specific to endorsement, the focus shifts away from evaluating the regulation itself.[1021] Instead, the assessment is centered on the *conduct* of a third-

[1021] This research will take the approach explained by ESMA in which it explained that endorsement evaluates the conduct of the third-country CRA and not the regulation of the third country.

country CRA, ensuring that "credit rating activities resulting in the issuing of such a credit rating comply with requirements for the issuing of credit ratings which are as stringent as those provided for in this Regulation."

The cumulative effect is that territorial extension can be indisputably demonstrated in both cases, offering compelling evidence of the extensive influence and applicability of EU law on a global scale.

The underlying implication of this phenomenon, as expounded earlier, is that if a third country fails to secure endorsement or equivalence, its recourse to avail these mechanisms entails the necessity to amend its domestic legislation. This process is inherently indicative of the far-reaching impact of EU law, aligning with what is commonly referred to as "The Brussels Effect."

In this context, it is intriguing to note that despite the loss of equivalence in 2019,[1022] the ASIC continues to affirm on its official website that its regulatory framework remains rooted in EU law. The statement reads as follows:

"Our guidance is given in the context of the evaluation conducted by the European Securities and Markets Authority (ESMA) under the European Commission's directive. The assessment aims to determine whether Australia's regulation and oversight of credit rating agencies are on par with the standards outlined in the European Union's Regulation on Credit Rating Agencies (EU Regulation). According to the EU Regulation, for ratings produced in Australia to be endorsed for use within the EU, the regulation and supervision of credit rating agencies in Australia must meet a level of stringency equal to that in the EU. Additionally, for credit rating

[1022] Commission Implementing Decision (EU) 2019/1276 of 29 July 2019 repealing Commission Implementing Decision 2012/627/EU on the recognition of the legal and supervisory framework of Australia as equivalent [2019] L 201/17 (n 25).

agencies based solely in Australia and without any legal presence in the EU, their ratings can be utilized in the EU only if the regulation and supervision of these agencies are deemed equivalent to those in the EU."

This statement serves as a substantial support for the attainment of Australian credit ratings' endorsement within EU endorsing CRAs. Consequently, it becomes evident that despite the deliberations on the "conduct" versus "legislation" dilemma as stated by ESMA, a third country is interpreting the requirement as a demand for its legislation to be "as stringent as" EU rules. This interpretation stresses the potential extraterritorial impact of this measure, highlighting how it extends beyond the EU's borders.

2.8 Conclusion

The withdrawal of equivalence for Australian Credit Rating Agencies (CRAs) in 2019 highlighted the influential role that instruments to allow third-country CRAs in the EU single market play in shaping international financial regulations. Australia, being a third country with limited influence on the EU financial market, could afford the decision not to modify its regulations to regain equivalence, showcasing the latitude that certain nations possess in making such choices. This scenario underscores the global reach of EU law, as the requirement to align with EU standards serves as a testament to the "Brussels Effect," where the extraterritorial influence of EU law extends beyond its borders.

Without equivalence, the availability of endorsement for Australian CRAs to have their credit ratings recognized within EU endorsing CRAs shows a crucial pathway for maintaining access to the EU single market. The pivotal distinction between "conduct" and "legislation" in this dilemma, while debated, showcases the significance of compliance with EU standards, whether through endorsement or equivalence, providing

evidence of territorial extension for EU law. The persistence of endorsement as an option in the absence of equivalence further reinforces this point, demonstrating the complex interaction between global regulatory standards and the specific requirements set by EU law.

In essence, the interaction between Australia, the EU, and the particulars of equivalence and endorsement mechanisms exemplifies the broader trend of the "Brussels Effect," wherein adherence to EU standards has become a global norm, even for countries with limited direct impact on the EU financial market. The withdrawal of equivalence for Australian CRAs serves as a compelling case study in the application of these regulatory mechanisms and their far-reaching consequences, underscoring the broader impact of EU law on international financial practices.

3 Case Study 2: Equivalence for UK CCPs and the Evolution of Tiered CCPs with Comparable Compliance

On one hand, the EU recognizes that central clearing significantly contributes to market transparency, reduces credit risk, and minimizes the risk of contagion in case of defaults by participants in a CCP.[1023] On the other hand, a substantial portion of euro-denominated OTC interest rate derivatives were being cleared in the UK.[1024] Therefore, the availability of these services holds a crucial role in maintaining financial stability, making equivalence decisions regarding UK CCPs of utmost importance.

[1023] Recital (2) Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the UK is equivalent [2022] OJ L 28/40.
[1024] Bank for International Settlements (BIS), 'Triennial Central Bank Survey of Foreign Exchange and Over-the-Counter (OTC) Derivatives Markets in 2019' (2019).

Furthermore, the EU and the UK have the ability to mutually recognize each other's legislation and supervision in specific sub-areas as equivalent, creating a level of market access similar to what was available with the European passport, but this equivalence process is unilateral and was not included in the negotiations for the future partnership.[1025]

3.1 Navigating the UK's Status as a Third Country in EU Context

The UK presents a fascinating and unique case study as a third country, owing to its relatively recent transition into this status. This distinction places the UK in a completely separate category when compared to countries like Australia. Its level of interdependency with the EU plays a pivotal role in illuminating the legal instruments to access the EU single market. Being a neighboring third country, the UK is seeking to establish agreements that maintain a close relationship with the EU. Nevertheless, the discussion surrounding financial services, particularly Central Counterparties (CCPs), remains a prominent point of contention due to its profound significance. Moreover, the notable absence of financial services provisions within the prior Trade and Cooperation Agreement (TCA) and the vague nature of the recently established Memorandum of Understanding between the EU and the UK underscore the complexities and challenges associated with the third-country approach in the realm of financial services.[1026]

Specifically, the alignment of UK rules with EU regulations is evident, given their historical convergence. Nevertheless, the intriguing aspect of

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[1025] Busch (n 310).

[1026] Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part, signed on 24 December 2020, OJ L 149, 30.4.2021; Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland (27 June 2023) (n 349).

this case lies in the notion that the UK, as a third country, could inadvertently shape EU law regarding financial services interactions with third countries. CCPs stand at the center of this study, as numerous scholars suggest that the genesis of EMIR 2.2 can be attributed to the Brexit context.[1027]

The EU passporting regime for commercial banking and clearing services ceased to apply between the EU and the UK after Brexit and the end of the transition period.[1028] Consequently, financial institutions licensed in the UK or an EU Member State are treated similarly to third country institutions in the respective opposite territory, resulting in limited market access.[1029]

Cross-border CCPs between the UK and the EU were also subject to authorization by competent authorities, with Euro-denominated clearing in the UK only permissible under ESMA's direct supervision as per the EMIR 2.2.[1030] Modifications to third country provisions in the EU and the UK are bound by international law, especially the GATS, necessitating equal market access for all third countries.[1031]

3.2 Background on Equivalence Decisions to UK CCPs

3.2.1 Brief Explanation of the Equivalence Decisions

On March 29, 2017, the UK submitted a notification of its intention to withdraw from the Union, as outlined in Article 50 of the Treaty on European Union. The Treaties' application to the UK would end either with the entry into force of a withdrawal agreement or, if that did not occur,

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[1027] Priem and Girard (n 103); Weinstein (n 27); Turing (n 978).
[1028] Öberg, 'Internal Market Acquis as a Tool in EU External Relations: From Integration to Disintegration' (n 351).
[1029] Shawn Donnelly, 'Post-Brexit Financial Services in the EU' (2023) 30 Journal of European Public Policy 787.
[1030] Canini (n 107).
[1031] Berger and Badenhoop (n 590).

two years following the notification—specifically, from March 30, 2019—unless a unanimous decision was reached by the European Council, in agreement with the United Kingdom, to extend this period, which at the end happened.

As outlined in the European Commission Communication of 13 November 2018 titled "Preparations for the UK's Withdrawal from the EU on 30 March 2019: Contingency Action Plan", a scenario where the UK withdrew without an agreement would pose potential financial stability risks for both the EU and its Member States.[1032] To mitigate these risks, it was reasonable and beneficial for the EU and its Member States to allow UK-based CCPs that have already obtained authorization to provide clearing services within the EU beyond 29 March 2019, but only for a limited period of time.

Consequently, the European Commission initially provided temporary equivalence to UK CCPs due to concerns about a potential no-deal Brexit.[1033] Therefore, ESMA acknowledged the recognition through equivalence of three UK CCPs, namely ICE Clear Europe Ltd, LCH Ltd (both

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[1032] European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank Preparing for the withdrawal of the United Kingdom from the European Union on 30 March 2019: a Contingency Action Plan, COM/2018/880 final, 13 November 2018.

[1033] Christy-Ann Petit and Thorsten Beck, 'Recent Trends in UK Financial Sector Regulation and Possible Implications for the EU, Including Its Approach to Equivalence' (2023). See more on Post-Brexit discussions: Manolis Kalaitzake, 'Brexit for Finance? Structural Interdependence as a Source of Financial Political Power within UK-EU Withdrawal Negotiations' (2021) 28 Review of International Political Economy 479; Henning Berger and Nikolai Badenhoop, *Financial Services and Brexit: Navigating Towards Future Market Access*, vol 19 (Springer International Publishing 2018); Dieter Pesendorfer, *Financial Markets (Dis)Integration in a Post-Brexit EU: Towards a More Resilient Financial System in Europe* (2020); Scott James and Lucia Quaglia, '9 Brexit and the Future UK – EU Relationship' in Scott James and Lucia Quaglia (eds), *The UK and Multi-level Financial Regulation: From Post-crisis Reform to Brexit* (2020).

Tier 2 CCPs with systemic nature),[1034] and LME Clear Ltd (a Tier 1 CCP).[1035] This initial equivalence period lasted until 30 March 2020[1036] and was extended twice, first through an amendment in April 2019 and then in December 2019 due to the UK's request for an Article 50 TEU extension.[1037] Initially set to expire at the end of June 2022,[1038] the equivalence has been further extended to run until 30 June 2025, following a subsequent extension in February 2022.[1039]

3.2.2 Key Factors that led to Equivalence Recognition

Under the European Union (Withdrawal) Act 2018, the UK adopted the terms of EMIR into its domestic law on 26 June 2018, to become effective from the day the UK officially exited the European Union. Consequently, until 31 December 2020, UK CCPs operated under the oversight of the Bank of England, as mandated by UK domestic law aligned with EMIR.

On the 17 October 2019, the European Union and the United Kingdom came to an agreement known as the Withdrawal Agreement, which included an updated Protocol concerning Ireland and Northern Ireland, along with a revised Political Declaration. Following the ratification of this agreement by the UK's House of Commons, approval by the European Parliament, and its finalization by the Council, the United Kingdom

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[1034] See more on the classification and meaning of tiered CCPs in Chapters VI and VII

[1035] European Securities and Markets Authority (ESMA), 'List of Third-Country Central Counterparties Recognised to Offer Services and Activities in the Union' (2023).

[1036] Commission Implementing Decision (EU) 2018/2047 of 20 December 2018 on the equivalence of the legal and supervisory framework applicable to stock exchanges in Switzerland in accordance with Directive 2014/65/EU [2018] OJ L 327/77, 21.12.2018.

[1037] Commission Implementing Decision (EU) 2019/544 of 3 April 2019 amending Implementing Decision (EU) 2018/2031 [2019] OJ L 95/9, 4.4.2019.

[1038] Commission Implementing Decision (EU) 2020/1308 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the UK is equivalent [2020] OJ L 306/1 21.9.2020.

[1039] Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the UK is equivalent [2022] OJ L 28/40 (n 1023).

transitioned into the status of a third country on the 1st of February 2020, leading to the cessation of Union law's application within the United Kingdom by the 31st of December 2020.[1040]

Therefore, the UK financial services were required to apply for equivalence from 1 January 2021. In this regard, Article 25(6) of EMIR outlines three prerequisites that must be satisfied to establish the equivalence of a third country's legal and supervisory arrangements concerning authorized CCPs within that jurisdiction:

-The first condition stipulates that the legal and supervisory systems of a third country must guarantee that CCPs within that country adhere to legally binding rules that are on par with the provisions outlined in Title IV of EMIR. The UK integrated the pertinent components of EMIR into its domestic legislation, and this incorporation became effective from the day the UK exited the Union. Consequently, the domestic laws of the UK could be regarded as equivalent to the stipulations established in Title IV of EMIR.

-The next condition pertains to the legal and supervisory structures of the third country, which must guarantee that CCPs established in that country are continually subject to effective supervision and enforcement. Up until the end of 2020, UK CCPs fell under the supervision of the Bank of England, as mandated by UK domestic legislation in alignment with EMIR. Furthermore, with the incorporation of this regulation into UK domestic law, the Bank of England retained its responsibility for the ongoing supervision of CCPs.

-Thirdly, as part of the decision-making to grant equivalence, the legal framework of the third country must establish an effective equivalent

[1040] ibid.

system for acknowledging CCPs authorized under that country's legal rules. The UK integrated the crucial elements of this equivalence system, as found in Article 25 of EMIR, into its domestic law. Nevertheless, the UK introduced a Temporary Recognition Regime, temporarily suspending key amendments to EMIR for a minimum of three years. This regime grants the Bank of England broad discretionary authority to revoke the 'temporary deemed recognition', resulting in legal ambiguity for CCPs recognized under this arrangement. Despite this uncertainty, the EU deemed that the third condition has been met. The timeframe was deemed insufficient to identify an alternative solution.[1041]

In spite of the uncertainty, the EU assessed that the third requirement was fulfilled. Hence, the UK's legal and supervisory framework, which applied to UK CCPs already in operation and authorized, was deemed equivalent to the standards specified in EMIR.

This decision was grounded in the information available at that moment to the European Commission regarding the legal and supervisory arrangements applicable to UK CCPs. However, these arrangements are equivalent only as long as the requirements stipulated in UK domestic law for CCPs are upheld, applied, and enforced. Therefore, the maintenance of the equivalence recognition is contingent upon future changes in the UK's regulatory and supervisory framework not adversely impacting equivalence in terms of regulation or supervision, leading to an unbalanced competitive landscape between UK CCPs and EU CCPs or posing risks to the financial stability of the EU. On the other hand, as the European Commission reserves the right to modify, suspend, review, or

[1041] European Commission, Communication from the Commission to the European Parliament, the Council, The European Central Bank, the European Economic and Social Committee, the Committee of the Regions of 19 January 2021, 'The European economic and financial system: fostering openness, strength and resilience', COM/2021/32 final, 19.1.2021.

rescind this decision at any point, effective information exchange and coordination of supervisory activities between the ESMA and the Bank of England is a prerequisite for preserving the recognition of equivalence until the expiration date of the decision.

For an effective exchange of information between ESMA and the Bank of England, it was essential to establish comprehensive and efficient cooperation arrangements in line with Article 25(7) of EMIR. These cooperation arrangements are designed to facilitate the proactive sharing of all pertinent information with the authorities outlined in Article 25(3) of EMIR. This includes entities like the ECB and other members of the European System of Central Banks, with the primary goal of consulting these authorities on matters related to the recognized status of UK CCPs or when such information is crucial for them to perform their supervisory duties. The cooperation arrangements under Article 25(7) ensure ESMA's access to immediate and ongoing information, including assessing risks posed by UK CCPs to the EU or its Member States.

In this regard, the ESMA and the Bank of England signed a Memorandum of Understanding (MoU) to set out arrangement for cooperation on the monitoring and supervision of CCPs established in the UK on 23 September 2020.[1042] The UK authorities are expected to keep the EU informed of any changes to their regulatory or supervisory framework that impact the provision of clearing services in the UK. Working alongside ESMA, the European Commission will closely monitor modifications made to the legal and supervisory arrangements that influence clearing services in the UK, market developments, and the efficacy of supervisory cooperation, which includes prompt information exchange between ESMA

[1042] Memorandum of Understanding between ESMA and the Bank of England to set out Arrangements for Cooperation on the Monitoring and Supervision of CCPs Established in the UK (23 September 2020).

and the Bank of England. It is important to highlight that the European Commission has the authority to conduct a review at any time if significant developments warrant a re-evaluation of the equivalence granted by the Decision. This includes cases where the UK authorities fail to effectively cooperate, hinder a proper assessment of the risk posed by UK CCPs to the EU or its Member States, or when actions taken by UK CCPs or the Bank of England lead to unfair competition.

Notwithstanding the equivalence, the EU has been clear in affirming that the current excessive dependence of EU clearing members on services offered by UK CCPs still poses threats to the financial stability of the EU and the smooth operation of its monetary policy, especially during periods of stress. This was verified by ESMA's evaluation in December 2021.[1043] In this assessment, three clearing services provided by UK CCPs were recognized as having significant systemic importance either to the EU or to one or more Member States. Although this evaluation concluded that, for the moment, the drawbacks of derecognizing these clearing services would be more significant than the advantages, it did highlight crucial risks and vulnerabilities related to the ongoing recognition of these clearing services, particularly in times of market stress.

Furthermore, as emphasized in the Communication on 'fostering openness, strength, and resilience', the EU considers crucial to further decrease exposures to UK CCPs that hold systemic importance for the EU, particularly for OTC derivative exposures involving euro and other EU currencies.[1044] The Decision's timeframe was agreed to provide sufficient

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[1043] European Securities and Markets Authority (ESMA), 'Assessment Report under Article 25(2c) of EMIR. Assessment of LCH Ltd and ICE Clear Europe Ltd. Part 1' (n 928); European Securities and Markets Authority (ESMA), 'Assessment Report under Article 25(2c) of EMIR. Assessment of LCH Ltd and ICE Clear Europe Ltd. Part 2' (n 982).

[1044] European Commission Communication from the Commission to the European Parliament, the Council, and The European Central Bank (n 1041).

opportunity for the advancement of clearing capabilities among EU CCPs, the exploration of methods to boost liquidity in these CCPs, and the expansion of the variety of clearing solutions provided by EU infrastructures.[1045] Moreover, the Decision should allow sufficient time for a thorough review of the EU's supervisory framework for CCPs.

3.3 Particulars of Equivalence in this Case. Overview of the Tiered System

This exceptional form of equivalence, which has been extended multiple times but remains limited in duration, exemplifies a fundamental characteristic of EU equivalence, namely, a temporary alignment of regulations.[1046] As previously mentioned, the most recent extension was implemented to prevent a sudden and disruptive scenario, referred to as a 'cliff-edge' situation, as highlighted by Commissioner McGuinness in November 2021, and to maintain short-term financial stability.[1047] The equivalence decision itself highlighted the considerable concentration within the central clearing market.[1048] Specifically, by the end of December 2020, a significant proportion (90%) of euro-denominated OTC interest rate derivatives were cleared by a single UK CCP, namely SwapClear, which operated under LCH Ltd.[1049] On the contrary,

[1045] Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the UK is equivalent [2022] OJ L 28/40 (n 1023).
[1046] Christy-Ann Petit and Thorsten Beck (n 1033).
[1047] European Commission, 'Commissioner McGuinness Announces Proposed Way Forward for Central Clearing' (*Statement*, 2021) <https://ec.europa.eu/commission/presscorner/detail/en/statement_21_5905> accessed 28 November 2023.
[1048] Recital (3) Commission Implementing Decision (EU) 2022/174 of 8 February 2022 determining, for a limited period of time, that the regulatory framework applicable to central counterparties in the UK is equivalent [2022] OJ L 28/40 (n 1023).
[1049] European Commission Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 648/2012, (EU) No 575/2013 and (EU) 2017/1131 (n 711).

participation in EU CCPs is limited, resulting in a more active market with greater trading volume in the UK.

The path forward for the EU in enhancing liquidity within its own CCPs and reducing reliance on UK CCPs presents a challenging endeavor, contingent upon the proactive involvement of the private sector. This complex task hinges on whether financial institutions opt to utilize EU-based CCPs, and the absence of a clear legal mechanism to facilitate this transition from the UK to the EU adds further intricacy. The EU's ability to achieve this goal will rely on creating a conducive environment for the financial industry to choose EU CCPs, but the current lack of specific legislative tools complicates the execution of such a shift. It is essential to monitor how these dynamics unfold in the coming period, shedding light on the effectiveness of the EU's efforts to bolster its own CCPs and reduce dependency on UK counterparts.

3.4 Overview of EMIR 2.2 and the Supervisory Changes Impacting CCPs in the UK

In 2019, a significant reform was introduced to the EMIR third-country regime for CCPs, fundamentally altering the supervision of third-country CCPs providing clearing services to the EU.[1050] Previously, these CCPs operated under a relatively lenient ESMA 'recognition' system, contingent on the adoption of an equivalence decision for the relevant third country, which did not involve on-shore supervision.[1051] The enactment of EMIR 2.2 in 2019 brought substantial changes to this system while retaining the foundational ESMA CCP “recognition” process and the necessity for a prior European Commission equivalence decision for the third country.[1052]

[1050] EMIR 2.2 (n 275).
[1051] Wymeersch, ‘Brexit and the Equivalence of Regulation and Supervision’ (n 777).
[1052] Recital 27-28 EMIR 2.2 (n 275).

The most important change regards a risk-based approach and entails escalating levels of ESMA oversight based on the categorization of CCPs as "Tier 1", "Tier 2", or "Tier 3" CCPs.[1053] For those CCPs that are systemically important for the EU's financial stability (or likely to become so), on-shore supervision by ESMA is mandated, designated as "Tier 2" CCPs. This provision is highly controversial because of its extraterritoriality, since it is ordering ESMA to supervise a third-country entity. In essence, Tier 2 CCPs would undergo "dual supervision" by both ESMA and the regulatory authorities of the third country.[1054] ESMA would possess complete access to information and wield identical regulatory authority over these Tier 2 CCPs as if they were operating within the EU.

However, that provision is not the most contentious. An intensely debated provision (not yet used) requires the compulsory relocation of the most systemically significant third country CCPs to the EU, labelled 'Tier 3' CCPs.[1055] Additionally, the oversight of 'Tier 1' CCPs (effectively CCPs not meeting the Tier 2 criteria) has been augmented, mainly through the introduction of new powers for ESMA such as information requests and the imposition of fines.

However, despite having extraterritorial effects, these provisions differ in their foundation compared to the territorial extension of provisions related to CRAs. The key distinction lies in the emphasis on financial stability. Whereas the provisions with territorial extension in the case of CRAs may potentially disrupt third countries' legislations, the extraterritorial provisions governing CCPs are primarily designed to safeguard financial stability. The core issue behind the EU's interest in overseeing the

[1053] Recital 32
[1054] Weinstein (n 27).
[1055] Moloney, 'Third Countries and EU Financial Market Access: Technocracy, Politics, and the End of Deference?' (n 981).

operations of systematically important CCPs in third countries, like the US or the UK post-Brexit, arises from concerns about financial contagion. If a significant CCP in these countries were to face insolvency, it could potentially jeopardize the financial stability of the EU.[1056]

3.5 Analysis from the UK Perspective

London serves as Europe's primary financial center, offering corporate and investment banking services not only to the EU's 28 member states but also to other regions.[1057] However, after Brexit, UK-based financial firms lost their ability to directly conduct business with clients in the remaining EU countries.[1058] Therefore, British financial institutions had been anticipating the impending challenges for a significant period and many of these institutions proactively shifted assets and operations to authorized group entities within the EU27.[1059] The culmination of this migration trend is not yet in sight.

The underlying concern lies in the potential disruption caused by the rapid exit of financial firms from London, posing a risk to financial markets. Both the EU and the UK have exercised utmost caution, recognizing the importance of implementing effective measures to prevent the emergence of systemic risks in the process. As anticipated, the negotiations have encountered significant difficulties in reaching agreement on multiple crucial aspects.

[1056] Weinstein (n 27).
[1057] Manolis Kalaitzake, 'Resilience in the City of London: The Fate of UK Financial Services after Brexit' (2022) 27 New Political Economy 610.
[1058] David Howarth and Lucia Quaglia, 'Brexit and the Battle for Financial Services' (2018) 25 Journal of European Public Policy 1118.
[1059] Busch (n 310).

3.5.1 Consequences of Brexit for UK CCPs' Market Access to the EU

The long-term consequences of Brexit on London's financial landscape and the EU27's financial sector remain uncertain, although initial changes are noticeable. Amsterdam has surpassed London as the epicenter for European equity trading.[1060] EY's data indicates that banks, insurers, and other financial entities have relocated approximately EUR 1,500 billion worth of assets to the EU27. A significant proportion of large corporations within London's financial district have faced adverse effects due to Brexit.[1061] British merchant bankers suggest that companies seeking stock exchange listings are now increasingly favoring Amsterdam due to the greater flexibility in rules provided by Euronext.[1062]

3.5.2 Memorandum of Understanding (MoU) establishing a Framework for Financial Services Regulatory Cooperation Between the European Union and the United Kingdom of Great Britain And Northern Ireland. Expectations Higher than Reality

On the contrary, there were significant expectations regarding the effectiveness of the Memorandum of Understanding between the EU and the UK. Unfortunately, it fell short of addressing critical aspects related to market access for UK firms, leading to disappointment. For example, with regards to equivalence, the memorandum only vaguely mentioned the establishment of a Joint EU-UK Financial Regulatory Forum to define shared objectives, leaving substantial questions about the operational details and the possibility of a new recognition framework

[1060] Martin Heneghan and Sarah Hall, 'The Emerging Geography of European Financial Centres: Fragmentation in the European Union and Concentration in the UK?' (2021) 28 European Urban and Regional Studies 40.
[1061] Berger and Badenhoop (n 590).
[1062] Busch (n 310).

unanswered.[1063] Consequently, both equivalence and comparable compliance continue to be the primary options available for third-country CCPs. The uncertainties persist, and the outcome of these arrangements is yet to be fully clarified after the first meeting of the Joint EU-UK Financial Regulatory Forum that will be held in September 2023.

3.6 Expanding the Global Reach of EU Law: Exploring Equivalence, Comparable Compliance, Territorial Extension and Extraterritoriality through the UK Case

The examination of extraterritorial reach in this scenario presents some unique aspects. Firstly, the CCPs (Central Counterparties) do not possess an alternative mechanism akin to equivalence within a third-country framework. Secondly, EMIR and its subsequent amendments have introduced multiple provisions that extend beyond the concept of equivalence, each having its distinct characteristics. Therefore, this study will comprehensively explore both territorial extension and extraterritoriality since the regulation and supervision of this specific service embody elements of both concepts in a distinctive manner.

Hence, the following section will first scrutinize the concept of equivalence as outlined in Article 25. Subsequently, it will delve into the examination of comparable compliance as stipulated in Article 25(a) introduced with EMIR 2.2 and the Commission Delegated Regulation 2020/1303.

3.7 Testing Territorial Extension and Extraterritoriality: An Analysis of Equivalence with Comparable Compliance in CCPs

This examination will involve dissecting various components of Scott's definition of territorial extension and Löber’s definition of

[1063] Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland (27 June 2023) (n 349).

extraterritoriality and applying them to the context of equivalence and the new elements of comparable compliance in the case of CCPs. Through this analysis, we aim to discern how these mechanisms work and whether they align with the concept of territorial extension as proposed by Scott (see definition in Section 2.6) and extraterritoriality as proposed by Löber.

3.7.1 Article 25: Recognition of a Third-country CCP also Known as Equivalence. Analysis of Territorial Extension

1. A Relevant Territorial Connection:

CCPs from a third country are capable of providing clearing services to the EU.

2. Regulatory Determination Shaped as a Matter of Law:

An implementing decision of the EU, carried out by the European Commission, determines whether equivalence is granted. If approved, the CCPs can offer their services as usual. Nevertheless, if not, or if the decision is subsequently withdrawn, the third country's recourse is to update its regulations to align with EU standards.

3. Conduct or Circumstances Abroad:

In this case, the European Commission will directly analyse whether the third country's legislation has the same effects EU law on CCPs has.

In conclusion, the notion of territorial extension is clearly exemplified by the equivalence decisions for CCPs, as they encompass all the essential elements that define this concept.

3.7.2 Article 25 (a) of CRA Regulation I and the Commission Delegated Regulation 2020/1304. Comparable Compliance of a third-country CCP. Analysis of Extraterritoriality.

As defined by Löber, chair of the CCP Supervisory Committee at ESMA, the concept of extraterritoriality in financial market infrastructures like

CCPs refers to situations where jurisdictions may stipulate that third-country financial market infrastructures must adhere to portions or the entirety of the local regulatory framework and this adherence is subject to verification by domestic regulatory bodies.[1064] Nonetheless, the application of extraterritoriality in the regulation of financial market infrastructures also necessitates a coordinated effort among regulatory authorities to ensure the harmonious implementation of overlapping requirements.[1065]

This concept becomes particularly evident when examining the scenario of comparable compliance for CCPs, where all the aspects of extraterritoriality come into play:

1. Jurisdictions may stipulate that third-country financial market infrastructures must adhere to portions or the entirety of the local regulatory framework

Article 25 (a) and the Commission Delegated Regulation 2020/1304 order that a CCP may be deemed to satisfy compliance with the requirements set out in Article 16 and Titles IV and V of EMIR when the CCP is considered systematically important.

2. This adherence is subject to verification by domestic regulatory bodies

ESMA mandates that third-country supervisory authorities provide confirmation on the adherence of a systematically important CCP to the guidelines stated in Article 16, as well as in Titles IV and V of EMIR, by ensuring compliance with their own domestic laws, previously recognized as equivalent by the European Commission. This is a crucial aspect of the oversight process.

[1064] Löber (n 28).
[1065] ibid.

3. Coordinated effort among regulatory authorities

EMIR 2.2 established that ESMA is tasked with coordinating activities among competent authorities and across various colleges to cultivate a shared supervisory culture and promote consistent supervisory practices. This includes ensuring standardized procedures and uniform approaches, as well as enhancing consistency in supervisory outcomes, particularly in areas with cross-border relevance or potential cross-border consequences.

Due to the factors discussed earlier, it's evident that "comparable compliance" constitutes an extraterritorial measure. In this instance, extraterritoriality is being used to ensure financial stability, a particularly critical concern given that the EU's most vital CCPs have transitioned into third-country status, heightening their supervision's significance for the entire system. Thus, this case exemplifies how the global reach of EU law is playing a pivotal role in preventing future crises. Nevertheless, this system is relatively recent, and its effectiveness, as well as the cooperation with the UK, still requires observation and evaluation.

3.8 Conclusion

In recent times, the UK's transition into a third country within the EU has triggered significant shifts in the landscape of third-country regimes within the field of financial services. The UK's historical importance in this domain prompted profound changes, leading to a reconsideration of the approaches employed for regulating certain financial activities, such as CCPs’ activities with third countries.

Of particular note is the concentration of CCPs in the UK, given their significance and interconnectedness, the EU recognized the necessity of granting equivalence to these CCPs, facilitated by the alignment of UK rules with EU regulations. Despite ongoing developments in UK financial

frameworks, such as the introduction of the Temporary Recognition Regime, the preservation of equivalence underscored the critical role CCPs play in maintaining financial stability and cross-border market operations.

Among equivalence, the EU embarked on developing a supplementary mechanism named comparable compliance. This innovative approach, particularly applicable to systematically important CCPs, vests ESMA with heightened authority to meticulously monitor the performance of third-country CCPs. The emergence of this framework, as exemplified by EMIR 2.2, has generated discussions regarding its extraterritorial impact, a matter debated due to the paramount importance of safeguarding financial stability.

Indeed, the complexities surrounding the regulatory landscape for CCPs warrant a balanced consideration of risks and benefits. While the extraterritorial features of EMIR 2.2 have raised debates, the risk presented by systematically important CCPs necessitates their supervision and regulation on a global scale to mitigate potential disruptions to financial stability.

However, despite these developments, the concept of equivalence remains intricate and fragmented. Continual evolution and unilateral features complicate its smooth implementation as a means of granting market access to UK CCPs. In parallel, the "Memorandum of Understanding between the EU and UK establishing a framework for financial services regulatory cooperation" was poised to resolve market access concerns. Yet, its provisions remain pending evaluation post the meetings of a Joint EU-UK Financial Regulatory Forum, reflecting the ongoing complexity of financial services access.

Consequently, in the current scenario, both equivalence and comparable compliance persist as pivotal instruments, navigating the intricate intersection of regulatory autonomy, financial stability, and cross-border market access. As the financial landscape continues to evolve and negotiations unfold, the equilibrium between these mechanisms will continue to shape the future of financial services interactions between the EU and the UK, resonating with the broader dynamics of global financial governance.

VIII GENERAL CONCLUSION

1 Summary of Findings

This research navigated the intricate landscape of CRAs and CCPs' regulation at international and EU level, with a particular focus on the implications of equivalence and endorsement mechanisms. The outcomes of this exploration underscore not only the global reach of EU law but also illustrate the complex interaction between financial stability and market access.

In the analysis of CRAs, this research uncovered the substantial impact of equivalence decisions, exemplified by the withdrawal of equivalence for Australian CRAs. This case highlighted the potential of equivalence decisions and the latitude that distant third countries like Australia possess in opting against regulatory modifications to regain equivalence. This scenario underscored the global reach of EU law and how it depends on the third country involved. On the other hand, endorsement as a viable alternative for Australian credit ratings through a Memorandum of Understanding demonstrated territorial extension in action, substantiating the concept of the "Brussels Effect."

Shifting the gaze to CCPs, the emergence of the UK as a new third country emphasized the pivotal role of equivalence decisions, especially given the concentration of CCPs in the UK. This research delved into the introduction of comparable compliance, a mechanism engineered to closely monitor systematically important third-country CCPs. Despite the contentious aspects of EMIR 2.2 in terms of extraterritoriality, its role in upholding financial stability within the framework of CCPs with significant inherent risks was highlighted.

Collectively, this research's findings illuminated the dual role of equivalence and endorsement within the contexts of CRAs and CCPs,

acting as tools for the extraterritorial extension and extraterritoriality of EU law. These mechanisms not only spotlight the EU's endeavor to exert its influence over global financial standards but also highlight the delicate equilibrium between territorial extension and extraterritoriality. While territorial extension draws third-country regulations closer to EU standards, extraterritoriality, exemplified by the likes of comparable compliance and EMIR 2.2, emphasizes the imperative of safeguarding financial stability.

The research further revealed that the concept of equivalence is a dynamic and evolving aspect of the regulatory landscape, characterized by ongoing developments that pose a challenge to consistent market access. Moreover, the examination of the "Memorandum of Understanding establishing a framework for financial services regulatory cooperation between the European Union and the United Kingdom of Great Britain and Northern Ireland" demonstrated a disparity between expectations and reality in the pursuit of a seamless regulatory framework for financial services between the EU and the UK. As this research concludes, it is evident that while equivalence and comparable compliance persist as the prevailing approaches for market access in the realm of Tier 2 CCPs, their effectiveness, coordination, and broader implications in the global financial realm merit continuous scrutiny.

2 Proposal to Enhance Cooperation in Financial Services

The EU's instruments to allow third-country CRAs and CCPs in the EU single market are part of an alternative approach due to the characteristics of the EU. This approach is alternative because it evaluates and considers supervision, regulation and enforcement regimes from third countries in order to determine whether these are equivalent or "as stringent as" the EU standards. Nevertheless, with this research, it could

be seen that endorsement and equivalence are good in theory but impractical in reality, especially because they have several administrative issues such as:

-Lack of Clarity and Transparency: One of the main difficulties is the lack of clear and transparent guidelines on the requirements and procedures for obtaining endorsement or equivalence because these are constantly changing. This can create uncertainty and ambiguity for both EU (when it comes to endorsement of CRAs) and third-country CRAs and CCPs, making it challenging to understand the regulatory expectations and comply with the necessary standards.

-Lengthy Approval Process: The approval process for obtaining equivalence or endorsement can be time-consuming and prolonged. Delays in the decision-making process can hinder the ability of third-country CRAs and CCPs to access the EU market promptly, impacting their competitiveness.

-Uncertain Duration of Approval: The EU's equivalence and endorsement decisions may not have a defined duration, leaving third-country CRAs and CCPs uncertain about the stability and continuity of their market access. This lack of clarity can impede long-term planning and investment decisions for third-country agencies and financial market infrastructures.

This research proposed an alternative solution to address the administrative complexities inherent in equivalence and endorsement mechanisms thorugh the implementation of mutual recognition-based frameworks. This approach introduces a reciprocal arrangement between pairs of states, allowing them to mutually recognize and accept each other's regulatory regimes. This mechanism offers a streamlined and pragmatic solution that mitigates some of the administrative hurdles

associated with equivalence and endorsement while fostering collaborative relationships between jurisdictions.

However, it's important to note that the mutual recognition-based framework also presents challenges and considerations. Jurisdictions engaging in such arrangements must be confident in the comparability and robustness of each other's regulatory regimes. Additionally, mechanisms for ongoing monitoring, collaboration, and dispute resolution need to be established to ensure the enduring effectiveness of the mutual recognition agreement.

In conclusion, adopting a mutual recognition-based framework as an alternative to equivalence and endorsement mechanisms offers a pragmatic solution to the administrative intricacies faced in the field of financial services regulation. This approach leverages collaborative bilateral agreements, promoting transparency, convergence, and effective regulatory oversight while streamlining market access for financial institutions across jurisdictions.

3 Leveraging the Global Impact of EU Law in Financial Services: A Focus on CRAs and CCPs

The complex exploration of extraterritoriality and territorial extension within the context of third-country CRAs and CCPs presents us a previously unknown territory within the elaborate landscape of EU regulatory practices related to market access. At its center lies the potent "Brussels effect," an outcome from the global reach of EU law facilitated by the endorsement and equivalence mechanisms. This effect, extends the boundaries of EU law well beyond its physical borders, fundamentally giving EU law the possibility of shaping the legislative landscapes of third countries and establishing the cornerstone of global financial standards.

On the other hand, the global reach of EU law is directly attached to the remarkable strength of its single market. The relationship of this reach with the broader global landscape underscores the delicate equilibrium the EU must strike: balancing its domestic interests, the imperative of an open market, and the indispensable need for unwavering financial stability. The notoriety of the latter factor is amplified by the potential risks in an interconnected world where cross-border provision of financial services is every day more common.

The exploration of the unfamiliar landscape encompassing CRAs, CCPs, and their interplay with EU regulations sheds light on the complex network of global financial regulation. Furthermore, it unveils that the decisions crafted within the EU's regulatory framework can have repercussions that extend well beyond its confines, traversing geographical boundaries and significantly molding the structure of the financial field. Nevertheless, this impact is not uniform; rather, it flexibly adjusts and transforms according to the nuanced specifics of each situation.

In conclusion, it becomes evident that comprehending the complex interplay of territorial extension, extraterritoriality, and the Brussels effect bears crucial implications for the EU's position as a global regulator, for third countries maneuvering through these dynamics, and for the overarching stability of the worldwide financial landscape. This research unequivocally highlights the paramount importance of agreeing on precedence to financial stability in the regulatory landscape of cross-jurisdictional financial services such as CRAs and CCPs. Moreover, it definitively establishes that the attainment of an appropriate degree of regulation and supervision for such services is contingent upon robust cooperation among countries.

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