How many Single Rulebooks?

Summary

This dissertation investigates the level of progress made towards achieving an EU Single Rulebook for investment management. Since the 1980s, EU policy makers have been striving to harmonise the rules on certain investment funds investing in transferable securities. This goal has been pursued with the Directive on Undertakings for Collective Investment in Transferable Securities (UCITS Directive) that was first adopted in 1985 and subsequently revised several times. In terms of policy design, this was done by using a minimum harmonisation directive. This means that the EU requirements on this matter were not directly applicable but first needed to be transposed into national law, while providing numerous explicit exemptions and national discretion to Member States in the way they implement key aspects of the directive. Moreover, minimum harmonisation means that EU Member States are free to impose stricter requirements (so called gold-plating). In contrast, all other forms of investment funds such as Hedge Funds and Private Equity remained outside of the scope of EU law and therefore fully subject to diverging national rules, where available.

However, following the 2007/2008 financial crisis, policy makers in the EU and globally identified the lacking regulatory consistency and the related unlevel playing field issues causing competitive distortions and creating the risk of regulatory arbitrage as a key lesson learned from the financial crisis. Both internationally at the G20 level and at the EU level, policy makers therefore vowed to put regulatory consistency at the heart of their post-crisis reform efforts. In the EU, this even prompted the creation of the EU Single Rulebook concept which, however, remained ambiguous as it has never been formally defined how this concept is precisely to be understood, which institutions are responsible to achieve it and how this should be done.

Notwithstanding the lack of conceptual clarity, EU policy makers quickly proceeded to adopt an unprecedent number of EU legal acts of high legal and technical complexity with a view to regulating all types of investment managers, frequently referred to by market participants as “*regulatory tsunami*” or “*regulatory avalanche*”, resulting in an increase of ongoing compliance costs of investment managers by over 1900% compared to pre-crisis times. However, despite explicit calls from EU and national parliaments, stakeholders, regulators as well as audit recommendations by the European Court of Auditors addressed to the European Commission to take stock to which extent the post-crisis reforms achieved their desired policy objectives, no such comprehensive analysis has been performed yet.

Therefore, there is still a gap both from a conceptual and empirical perspective and persisting struggle among policy makers and scholars to understand (1) what the EU Single Rulebook precisely signifies as it has never been clearly defined in any official EU document and (2) the level of progress made since its inception towards establishing a unified rulebook that is internally consistent and creates a level playing field among market participants across the EU/EEA. In light of this, the central research question of this dissertation is as follows: *To what extent did the enormous post-crisis reforms in the area of investment management to establish an EU Single Rulebook achieve the desired policy objectives of ensuring regulatory consistency and creating a level playing field across Member States?*

To address this central research question, this dissertation entails four studies providing conceptual and empirical contributions to the debate among scholars and policy makers on regulatory consistency and the EU Single Rulebook.

The first study (Chapter 2) deals with the question of how the novel EU Single Rulebook can be understood conceptually, investigating how the initial proponents of the EU Single Rulebook concept envisaged its design, how it is embedded in the academic literature and how it has been understood and applied by policy makers in the area of investment management. The findings of this study demonstrate that the initial proponents of the Single Rulebook concept conceived it as a revolutionary step in the EU integration process, moving away from pre-crisis policy design approach of regulating the financial sector through minimum harmonisation directives to using directly applicable regulations with a view to creating identical rules across all Member States. As a second-best option, the initial proponents advised to use maximum harmonisation directives that do not allow for gold-plating and national discretion in the form of explicit exemptions or derogations. However, policy makers in the area of investment management misconceived or reframed this concept to merely signify a long-term policy objective of achieving greater levels of EU harmonisation, without necessarily changing the policy design or choice of legal instruments used to attain this goal. One of the reasons for contradictions on the suitable policy design is the timing of the Directive on Alternative Investment Fund Managers (AIFMD), as it was put forward in early 2009 and therefore during a period where the discussions on the EU Single Rulebook concept were still ongoing and this novel concept had not yet been fully embraced by the EU institutions. Subsequently, EU policy makers faced increasing pressure from the media and politicians including heads of states such as

French President Nicolas Sarkozy and German Chancellor Angela Merkel to act swiftly to regulate so called shadow banks, in particular Hedge Funds and Private Equity. As a result of this, EU policy makers ended up creating a very complex multi-tiered Single Rulebook comprised, *inter alia*, of a multitude of over two dozen minimum harmonisation directives and directly applicable regulations at EU level and 30 national rulebooks with various specificities across the EU and EEA. Market participants, investors and supervisors in the EU Single Market therefore still do not benefit from a truly unified Single Rulebook but have to navigate through a multitude of EU and national rulebooks with additional layers of rules (gold-plating) or lesser rules (exemptions and derogations) in the different Member States.

The second study (Chapter 3) deals with the question whether the EU Single Rulebook has been underpinned by a coherent policy paradigm. Scholars have been debating whether the financial crisis triggered a paradigm change in the way policy makers approached the regulation of financial markets, as would be expected under Peter Hall's policy paradigm framework. The case study performed in this study examined the role of paradigm coherence in the pre- and post-crisis EU legal acts on investment management. The findings of this study demonstrate that despite all preconditions of Hall's framework being met, EU policy makers never used a single coherent paradigm as would be expected under Hall's framework, but rather a mixture of paradigms as advocated by the policy bricolage literature. However, as demonstrated with this study, the bricolage model supported by part of the policy change literature may also benefit from a further conceptualisation to allow for a better distinction between directional and non-directional bricolage. This is because while EU policy makers did use a mixture of paradigms both before and after the crisis, we can still discern a strong shift since the 2007/2008 financial crisis towards creating greater ideational coherence, namely moving away from the neoliberal or market-making paradigm towards the market shaping-paradigm. This trend is likely going to continue or even accelerate given the departure of the UK from the EU and therefore one of the historically strongest proponents of the market-making paradigm. The findings of this study indicate that a precondition for achieving regulatory consistency is to formulate policies on the basis of a coherent policy paradigm, especially when reading this study in conjunction with the empirical findings of the third and fourth study.

The third study (Chapter 4) addresses the question to which extent the rules set out in the EU legal acts on investment management are internally consistent. This

study first contextualises the EU Single Rulebook concept in light of the origins and rationale of the EU constitutional principle of regulatory consistency. Despite its relatively long history and increasing importance in EU law, in particular in the area of financial regulation since the creation of the EU Single Rulebook concept, the principle of regulatory consistency remains largely elusive due to a lack of definitions in official documents. In a second step, the study performed a comparative case study between the AIFM and UCITS Directives and other relevant EU acts. The analysis identified significant regulatory differences in key areas of regulation, notably with respect to requirements relating to authorisation, marketing/investor protection, risk management and supervisory powers and responsibilities. The majority of the differences identified are to be viewed as significant regulatory inconsistencies since they cannot be reasonably justified taking into account the specificities of the relevant financial products, the policy objectives of investor protection and financial stability and the overarching policy goal of creating an EU Single Rulebook that ensures regulatory consistency. Therefore, similar financial products and market participants posing similar risks are currently subject to different regulatory treatments in key areas of regulation which contradicts both the principle of regulatory consistency and the EU Single Rulebook objective. This outcome is ultimately a result of EU policy makers having (1) adopted a rather complex patchwork design for the regulation of the investment management sector with a multitude of separate regulations and minimum harmonisation directives and (2) following a form-over-substance approach, meaning that the applicable rules are not based on actual activity or asset-specific risks but on the contrived legal form and (voluntary) label of the product as well as the regulatory status and location of its manager. While some of these regulatory inconsistencies are in the process of being addressed by EU policy makers, notably in the context of the AIFMD review, many others remain unidentified and unaddressed.

The fourth study (Chapter 5) addresses the question whether the EU Single Rulebook achieves its policy goal of creating a level playing field at the national level. This question is investigated by performing a comparative study of the implementation of the AIFMD in Germany and Luxembourg, two leading centres for investment management in Europe and the world. The findings of this study demonstrate that these two key Member States in the area of investment management made vastly different use of the many exemptions and wide national discretions provided by the AIFMD given its design as a minimum harmonisation directive. The comparative case

study identifies regulatory inconsistencies in key areas of regulation such as on regulatory safeguards to protect retail investors, financial product standards, manager requirements and treatment of non-EU managers and funds. This creates an overall situation in which there are significant inconsistencies in key areas of regulation between two key fund jurisdictions and thus an unlevel playing field for market participants operating in the Single Market and incentives for regulatory arbitrage. To this end, while the implementation of the AIFMD has been done formally and legally correct in both Member States, the final policy outcomes in terms of regulatory consistency might rather go against or impede the overarching EU policy goal of creating an EU Single Rulebook that creates a level playing field and avoids regulatory arbitrage. This supports the central argument put forward in this dissertation that the completion of the EU Single Rulebook intrinsically requires the use of a policy design that is based on directly applicable EU regulations as envisaged by the initial proponents of the Single Rulebook concept. This is particularly important given the fact that the findings of the study also indicate that national policy paradigms are much more deeply rooted in the history of the country and may therefore persevere across times and political aisles.

The main conclusion of this dissertation is that while the EU has come a long way with the EU Single Rulebook concept to improve regulatory consistency of investment management regulation and create a level playing field among market participants from different Member States operating in the Single Market, there are still significant shortcomings due to a lack of a coherent policy paradigm and the choice of a policy design that is both complex and less effective in creating regulatory consistency at the EU and national level.