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Minto, Andrea

Published in:
European Company and Financial Law Review

DOI:
10.1515/ecfr-2018-0024

Publication date:
2018

Document version
Final published version

Citation for published version (APA):

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Banking Crisis Management, Recovery and Resolution Planning, and “New Governance” Theory: Approaching “Living Wills” as a Public-Private Collaborative Form of Regulation

by

Andrea Minto*

Over the last ten years the architecture of financial regulation and supervision in Europe has undergone sweeping changes. The demise of the previous “laissez faire era” unleashed an extraordinary torrent of EU institutional and regulatory reforms. Approaches, methodologies and tools by which financial institutions are regulated have drastically been revised to cope with the increasing complexity of modern financial intermediation. New forms of collaborative and polycentric governance in fact emerged as to better respond to sophisticated market failures, opening up to amplified participation and power-sharing between “public” and “private” actors. Crisis management and bank resolution represent an interesting area where regulators reserved some room for a public-private collaborative form of regulation. While there is some extensive scholarship placing recovery and resolution planning at the intersection of ex ante and ex post regulatory strategies, little attention has been paid to the specific modes of interaction between regulators and regulated entities. This study aims to advance knowledge by assessing the main features of “living wills” regulation in the light of the “new governance” theory. In so doing, it emphasizes the advantages of a dynamic cooperation between public (governments, regulators) and private (regulated) parties in overcoming looming market failures such as informational asymmetries and moral hazard.

* Ca’ Foscari University of Venice and University of Southern Denmark. Policy Adviser at the Deutsche Bundesbank Eurosystem. I am indebted to the SRB staff for their practical suggestions on how to improve the analysis. I would like to thank all the Bundesbank staff members who contributed with useful input and fruitful discussions. In particular, I would like to thank Emanuele Spina, Senior Legal Expert in Banking Regulation and Resolution at the Single Resolution Board, and Thomas Droll, Head of Section Makroprudenziale Überwachung des Nicht-Bankensystems, DG Financial Stability – Deutsche Bundesbank Eurosystem, for their comments on earlier drafts. I am also grateful to all members of RENFORCE (Utrecht Centre for Regulation and Enforcement in Europe – Universiteit Utrecht) for the valuable input received along the way of writing this article. I am grateful to Charlotte Bille-Hasselstrøm (University of Southern Denmark) for the editorial assistance. The views expressed in this article represent the Author’s opinion only and do not reflect those of the Institution(s) he works for.
1. Introduction. The post-crisis institutional architecture of banking regulation and supervision in Europe

A fundamental re-thinking is currently underway throughout the world about how to cope with the regulatory challenges that modern financial intermediation brings up. In Europe the institutional architecture of banking regulation and supervision has undergone sweeping changes over the last years. The 2007-2008 great financial crisis (GFC) and the detrimental economic consequences that came with it, unleashed an extraordinary torrent of EU institutional and regulatory reforms. Underlying much of this reform surge is a wide array of forces that illustrate how market practices, business and consumption patterns, attitudes and behaviours upended the former institutional setting over time.

The first stage of the GFC was in fact driven by a number of factors – heterogeneous supervisory practices, global macroeconomic imbalances, wave of financial innovation, disconnection between macro- and micro-prudential supervision – which revealed the fragility of a single market for banking and financial services built upon the pillars of “minimum harmonization and mutual recognition”.

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2 PG Texeira, Europeanising prudential banking supervision. Legal Foundations and Implications for European Integration. in JE Fossum and AJ Menéndez (eds), The European
Such pillars sought to stimulate cross-border operations by facilitating the establishment of branches in other EU Member States, “passporting” home EU Member State authorizations and harmonising technical standards. Back to 1980s and early 1990s, the EU policy agenda was indeed projected to promote trust between EU Member States by underpinning the process of ‘passporting’ home state authorisations through minimum administrative prudential regulation and supervision for banks and investment businesses seeking to operate across borders. This architecture, however, proved outdated to sustain the critical dimension and interconnections reached by the single market in the new millennium and somehow turned out to have exacerbated the detrimental effects of the crisis in Europe3.

The regulatory heterogeneity and fragmentation arising from such construction constituted a commonly identified contributor to crisis conditions4. Not only had it opened up to regulatory arbitrage practices in the first place, but, once the crisis hit, it prevented policy-makers and supervisors alike from taking any appropriate action to deal with a highly intertwined and interconnected market.

As pointed out in the Larosière Report, when the crisis unfolded, it emerged that the European Union’s regulatory and supervisory framework was “fragmented along national lines despite the substantial progress achieved in financial market integration and the increased importance of cross border entities”5. This indeed led to the second phase of the crisis. The vicious spiral between banking crisis and sovereign debts, culminating in some infamous bail-outs6, showed the lack of an appropriate financial regulatory and supervisory archi-

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3 Indeed, the unheard warning that had been given ahead of the economic crisis by Tommaso Padoa-Schioppa on the inadequacy of the minimum harmonization principle was eventually learned the hard way: a long lasting integration of markets and a single monetary policy cannot be achieved while keeping regulation and supervision at national level (the inconsistent triad): T Padoa-Schioppa, How to deal with emerging pan-European financial institutions?, 2004, speech at the Conference on Supervisory Convergence organized by Dutch Financial Minister, The Hague, available at https://www.ecb.europa.eu/press/key/date/2004/html/sp041103.en.html.


6 For a study on the mechanisms through which sovereign and bank problems feed into each other, see i.e. I Balteanu and A Erce, Bank Crises and Sovereign Defaults: Exploring the Links, Banco de Espana, 2014, n. 1414.
architecture to keep up with modern market dynamics. The strong nexus between the credit risks of financial sectors and their sovereigns was likely the very push for creating the European banking union and for equipping supervisors with a harmonized set of tools to manage a bank crisis.

To overcome these deficiencies and to foster regulatory convergence beyond minimum harmonisation, the EU produced an overhaul of the institutional structure of the European financial sector. As well-known, the institutional architecture changed significantly in response to the financial crisis and involved empowering three new EU-level agencies (EBA, ESMA, EIOPA) with sectorial regulatory tasks and the creation of the European Systemic Risk Board (ESRB). In addition, the EU sovereign debt crisis gave impetus to the creation of the European Banking Union which sits on the three pillars of the Single Supervisory Mechanism, the Single Resolution Mechanism, and the European Deposit Insurance Scheme.

Despite art. 127.6 TFEU being the legal basis for the Single Supervisory Mechanism, art. 1 SSM Regulation (Regulation 1024/2013) significantly and overtly emphasises that the ECB has been endowed with the “specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system, while ensuring the creation of a level playing field (i.e. having “full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage”).

Such rapid expansion of the institutional infrastructure brought about new actors, powers, and tools. Yet, a much more profound process of change started off along the way, affecting in certain aspects a new governance regulatory technique. Not only had the institutional design developed, but the industry itself – as a nexus of parties – had in turn confronted a structural change, especially in the way regulators, supervisors, financial institutions and end consumers now interact. The multilevel and composite architecture is thus accompanied – and supported – by a new composite regulatory paradigm, or legal order, which is based upon a wide range of regulatory strategies, where “external” regulation and “internal” regulation (i.e. regulation produced and enforced from the outside and from the inside of regulated entities, respectively) co-exist.

7 European Parliament, Vicious circles. The interplay between Europe’s financial and sovereign debt crises, Policy Briefing, June 2016.
8 What Lawrence Lessig referred to as “architecture”—the code, protocols, platforms and structures that determine how firms, consumers and policy- and law-makers interact (see L Lessig, Code, 2006, New York, 122).
Traditional regulatory approaches – spanning along the continuum rules-based/principles-based approach – have been reshaped by increasing involvement of non-state actors. Systems of government aimed at delivering greater efficiency and more responsive and flexible public services brought about innovations in the organizational structures. In fact, financial regulation is coupled with rule making delegation (de-legification) to both administrative bodies (supervisors) and private actors (regulated entities, associations and other standard setters). This generally means that legislation is used in principle only to set the outline through general policy principles to be implemented and supplemented by administrative regulation and self-regulation respectively.

In a governance perspective, this reflects a paradigm whereby regulatory convergence is achieved by involving parties which are better positioned than politicians and regulators, owing both to their superior expertise and greater and more timely access to firm-specific and market information.

Against such a backdrop, this article has two primary objectives: first, it aims to explore the looming market failures presented by modern financial intermediation and how these affect the style and design of the corresponding legal responses; and second, it seeks to explain the growing engagement of private actors in the governance tools that shape and constitute public policy and regulation.

We contend that new governance scholarship aids in getting a better understanding of the general trend in the financial regulation and the incorporation of internal private regulations into supervisory public planning. From general to specific, we then use such theoretical framework to examine recovery and resolution planning (living wills regulation). Cognisant of previous attempts to classify living wills regulation, this article argues that all such attempts might be reconciled under the new governance scholarship. In pursuit of its objectives, this article therefore seeks to provide a different perspective for thinking about recovery and resolution planning and its wide-ranging effects on the parties involved in drawing them out.

The article proceeds as follows: Par. 2 provides an overview. It starts off by briefly describing the general features of the market failures financial regulators have to cope with. Then, it explains why and how innovation and modern financial intermediation changed the style and design of regulation. It highlights the composite legal order and the different actors involved in law-making. Par. 3 elaborates further upon the composite legal order of financial markets by flashing out the different legal sources and the actors involved in

\[9 \text{ “Recovery and resolution planning” and “living wills regulation” are used interchangeably in the text.}\]
the law-making process. Par. 4 then scrutinizes the main tenets of “new governance” scholarship and why it is particularly informative in describing the current multi-level and composite institutional architecture of banking supervision and regulation in Europe. Par. 5 approaches recovery and resolution planning specifically and points out their main characteristics. Building on the discussion of the previous two paragraphs, Par. 6 contends with emerging implications. It utilizes the new governance theory as a basis for explaining the increased involvement of private actors. This article ends with a forward-looking conclusion. It envisages the early stage of banking crisis management as a prolific terrain for public-private collaborative forms of regulation in line with the tenets of new governance scholarship. Greater interaction between regulators-supervisors-and regulated entities in this area is deemed to have a number of advantages over conventional “top-down” regulation.

2. Market failures and complexity of modern financial intermediation

The crisis has deeply questioned the market’s ability to address severe externalities, especially those stemming from bail-outs and systemic turmoil. EU financial regulation is now routinely discussed in terms of incentives, asymmetries of information, multiple policy options, market-based instruments, quantification of benefits and costs, red-tape alerts and cost-effectiveness. In the aftermath of the crisis, in fact, EU policy-makers have rightly focused on potential solutions to the manifold conflicts of interest and regulatory lacunae that existed in the previous system. On the other hand, market failures that passed unnoticed before are now incorporated within the threats regulators and supervisors have to cope with.10

10 According to J. Snider, The Conundrum of Financial Regulation: Origins, Controversies, and Prospects, 2011, 7, Annual Review of Law and Social Science, 121, in the age of financial liberalisation and financialisation, market-based concepts have dominated the discourse on public regulatory goals, such that regulatory goals were grounded on notions of efficiency and transaction facilitation. Following the GFC, financial regulation seems to be mainly concerned with the public good of financial stability. In spite of what appeared to be individually sound and well supervised financial institutions, risks that were thought to be well diversified, and institutional infrastructures that appear to be robust, systemic risks nonetheless emerged, went undetected for some time and then created great havoc. Since then, through better analytical modelling, information gathering, identification, and monitoring as well as focus on macro-prudential policies, systemic risk has received greater focus. On the prominence of financial stability within the goals of financial regulation (along with the advent of macro-prudential approach to safeguarding it), see, i.e., SL Schwartz, Systemic Risk, Duke Law School Legal Studies Paper No. 163, Georgetown Law Journal, Vol. 97, No. 1, 2008; CJ Green, EJ Pentecost, TG Weyman-Jones, The Financial Crisis and the Regulation of Finance, 2011, 101 ff.; SG
“The design of financial regulation is thus ultimately an exercise in economics – applying the analytic tools of economics to determine the legal and regulatory framework best suited to correcting the failures of financial systems”\textsuperscript{11}. Economic scholarship explained this greater “market-failure thinking” by referring to the “public interest approach” to regulation\textsuperscript{12}. In its simplest, it is in the (EU) public economic interest to ensure the proper functioning of the internal market (in turn, instrumental to pursuing the economic goals in the Treaties\textsuperscript{13}) by overcoming or removing market failures. Particular features of financial markets make them especially prone to malfunction, failing thus to achieve the economically efficient outcomes which they are theoretically assumed to achieve\textsuperscript{14}.

Market imperfections are indeed endemic in the financial sector, due to the very factors of production that are traded and allocated between market participants: “time”, “information”, and “risk”. Complexity of financial intermediation is thus a reflection of the conundrum to manage risks stemming from a great deal of uncertainty\textsuperscript{15}. The pre-eminent role in risk allocation that the financial sector carries out in turn accentuates the manifestation of market failures: asymmetric information, moral hazard, bounded rationality, negative externalities are in fact direct functions of the properties of financial markets and of the host of contrasting interests that revolve around them. Steven L. Schwarcz argues that four types of market failures are inherent in the financial system – information failure, principal-agent failure, incentive failure,  

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\textsuperscript{15} D Moss, When All Else Fails: Government as the Ultimate Risk Manager, Cambridge, MA: Harvard University Press 2002.
and responsibility failure\textsuperscript{16} – and shows how these market failures can eventually contribute and lead, individually or in combination, to systemic failures as the overarching economic vulnerability\textsuperscript{17}.

Not only are market failures greater or more likely to come about in the financial sector, but the remedial intervention to cope with them is also extremely difficult to devise. The financial sector is therefore particularly inclined to market failures and non-market failures (or government failures) alike, as the costs of remedying the deficiency are often greater than the benefits.\textsuperscript{18} Indeed, some of the regulatory strategies that were conceived as to address and solve market failures turned out to fall short from achieving the desired outcome, or even to exacerbate them\textsuperscript{19}.

By the beginning of the twenty-first century, the advent of globalisation and financial liberalisation made financial markets much more vast, complex, aggressive and highly competitive\textsuperscript{20}. Such a period was accompanied by deregulation and a held wisdom in the full empowerment of non-public entities involved in standard setting, supervision and securing compliance\textsuperscript{21}.

\textsuperscript{16} SL Schwarcz, \textit{Regulating Shadows: Financial Regulation and Responsibility Failure} (April 11, 2013). Washington and Lee Law Review, Forthcoming. Available at SSRN: https://ssrn.com/abstract=2159455 or http://dx.doi.org/10.2139/ssrn.2159455. The author explains that “responsibility failure focuses attention on the fact that the corporate reorganization provisions of bankruptcy law may protect firms, thereby motivating the m to operate irresponsibly”. Nevertheless, the argument goes, “the protection afforded by those provisions does not mean that a firm will in fact operate irresponsibly or that acting irresponsibly will necessarily result in harm to third parties”.


\textsuperscript{21} This phenomenon is set against the backdrop of the ideological movement from liberal political economy to neo-liberalism and the predominance of economic theories of
Nonetheless, the GFC exerted a profound influence on how to regulate financial markets and institutions. The pervasive belief in the social desirability of unfettered market was in fact abandoned, since private actors – unregulated – proved to be neither rational nor fully informed as to master risk effectively. They often pursued vested private interests in conflict with the public good and lacked any form of public accountability. Market fundamentalism therefore stopped informing public policy, and a more intrusive form of regulation gathered momentum, especially to account for both the complexity of modern financial markets and the nature and pace of financial innovation.

Over the last decade, in fact, finance has been shifting increasingly from an industry characterised by brick-and-mortar bank branches towards an industry comprised of heterogeneous providers of services that are extended to customers via a multitude of channels and devices. Financial innovation has deeply influenced law-making, ever since it passed from being a “product/service changer” only, to a “game changer”.


processes alike. A vast amount of literature studied the progress of novel financial products and scrutinized the implications that have come with it. One strand of economic scholarship mapped out the ability of technological improvements to increase efficiency whenever something new that reduces costs, reduces risks or provides an improved product/service is being created. On the other hand, the 2007–2008 GFC showed that financial innovation might land far from attaining services that better satisfy financial system participants’ demand.

Quite to the contrary, financial innovation could result in products which are designed to obscure the attendant risks and which are traded in opaque dealer-intermediated markets by opaque financial institutions, ultimately making end financial consumers worse off. Credit default swaps, residential mortgage-backed securities, and collateralised debt obligations have ignited a great deal of discussion on informational asymmetry between intermediaries and investors, agency problems and transaction costs as well as on the relationship between financial innovation and financial stability.


27 See, i.e., N Gennaioli, A Shleifer, RW Vishny, Neglected risks, financial innovation and financial fragility, Journal of Financial Economics, 2012, 104(3), 452–468. Some scholars argue that financial innovation correlates with increased systemic risk for the financial and economic systems. Since financial innovation involves more credit creation, such increases in leverage as a systemic phenomenon often creates greater risk for all participants and could raise systemic fragility in the face of shocks or crises: T Adam, A Guetter, Pitfalls and perils of financial innovation: The use of CDS by corporate bond funds, Journal of Banking and Finance, 2015, 55, 204; T Yorulmazer, Has financial innovation
The negative economic and social consequences provoked by these sophisticated products have exerted a profound influence on how financial innovation is perceived and, perhaps most significantly, revealed the intellectual challenge to adequately account for both the “good” and the “bad” of it.  

Complexity and innovation are therefore to be considered root causes of greater and more sophisticated markets failures, since they have combined to generate significant asymmetries of information, exacerbated agency costs problems and moral hazard conducts within financial markets. Besides aggravating already pervasive market failures, they also gave rise to new issues leading up to “too-interconnected-to-fail” situations, the full implications of which we are only just now beginning to understand.

As to keep up to such fluid and dynamic market practices, the EU regulatory framework evolved along two trajectories.

On one side, a comprehensive and detailed new set of harmonised provisions have been produced, both at level 1 (Directives and Regulations) and level 2 (implementing measures released by the ESAs). On the other side, ad hoc venues for self-regulation have been opened up, as a way to better adapt to the rash developments occurring in the financial markets and so to properly respond to the intensified potential market failures and negative externalities. The “command-and-control rules-based and principles-based techniques have thus been enriched by self-regulation, consisting of self-imposed or self-enforced rules. In that respect, Marco Lamandini and David Ramos Muñoz have taken the view that external regulation and self-regulation have become intertwined and mutually reinforcing, up to the point that they are “bond to co-exist”: “This would make self-regulation an “add on” in respect to external regulation and it would...”

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30 F Cafaggi, Rethinking Private Regulation in the European Regulatory Space, 22, classified self-regulation in the following categories as: (i) mandated private regulation, where an industry is required or designated by the government to formulate and enforce norms within a framework set by the government; (ii) sanctioned private regulation, in which a private body formulate the norms which are then subjected to governmental approval; (iii) coerced private regulation, where the industry formulates the norms in response to threats by the government that if it does not it will impose statutory regulation; (iv) voluntary private regulation, where there is no active state involvement.
be capable of bringing about additional gains in social welfare, which would not be made, however, compulsory by external regulation”31.

3. On the interplay between public and private modes of regulation: from a “pyramid” to a “circle”

Although the GFC has led to a resurgence of public regulatory power, no amount of re-regulation could ever elevate the State to a position of substitute for the variety of actors in governance that have arisen, nor is that an ideal position whether from a practical or normative point of view32.

Thus, the financial sector situates in a multilevel or “decentred” regulatory space33, which is indeed the result of complexity, fragmentation, interdependencies, un-governability and the rejection of a clear private-public distinction34. The European financial regulatory framework extends to a wide array of “regulatory tools” which encompass “external regulation, recommendations, guidelines as well as self-regulation/internal regulation. The decentred analysis acknowledges that the financial services industry is a powerful and innovative industry that has been able to exert self-governance over many of its activities, if properly empowered and supervised35. Over the last years


32 H Wilke, Governance in a Disenchanted World (Cheltenham: Edward Elgar 2009).


34 Black indeed argues that decentred regulation is premised on these five preconditions. ‘Complexity’ refers to the nature of problems that may need to be dealt with. ‘Fragmentation’ refers to the fragmentation of knowledge, resources and capacity for control in the regulatory space. ‘Interdependencies’ refers to the dynamics between the participants in the regulatory space, coproducing and co-enforcing norms of governance. ‘Ungovernability’ refers to the autonomy and unpredictability of actor behaviour in the regulatory space, which will pose challenges to assumptions made by regulatory authorities. In a decentred landscape, there is, some argue, no public-private distinction as all participants contribute to and influence governance.

regulators have in fact been actively encouraging the financial sector to take leadership to develop forms of reflexive regulation to govern the sector’s activity, emphasising recourse to market-based solutions instead of the, at times, inappropriate hand of regulation36. However, contrary to deregulation practices, in the current regulatory space, regulators arguably remain entrusted with the powers to protect and take care of “public interest” or “public good” (in the economic sense of public goods that are not supplied for failure of collective action on the part of the market)37. The “public” character of regulators in the regulatory space is arguably distinct and this is conceptually sustainable even if the regulatory space is decentralised.

More broadly, the regulatory landscape in the European financial sector has become a composite legal order which comprises many sets of rules at different levels, and a diversified range of actors engaged in producing them.

Such a new legal order has been depicted as a policy and regulatory “circle” (or “wheel”) as contrasted to the hierarchical pyramid38. Unlike the pyramidal structure, the wheel accounts for the current multilevel institutional setting and the multiplicity of public and private actors implicated in the process of financial regulation. It illustrates the co-existence of global to local and public to private actors, with a variety of sources and a variety of modes of regulation. Hard law relies extensively on soft law and leaves appropriate room to self-regulation. Governance and markets tend to be tangled with each other, and so do the parties involved in drafting and developing the regulatory framework39. Elaborating


upon the regulatory wheel developed by Marco Lamandini\textsuperscript{40}, such mutual reinforcing interaction between international standard setters, law-makers, supervisors and private actors could be graphically sketched out by this scheme:

![Regulatory Wheel Diagram](image)

The decentred landscape is dominated by state-based regulators alongside with international bodies and standard-setters (such as the Bank for International Settlements, IOSCO, IMF and FSB) and private financial services industry participants and national competent authorities. This is reflected in the co-existence of hard and soft law, which are equally contributing in moulding the legal space, in a sort of “participative style of management”\textsuperscript{41}.

The graph is divided into 4 quadrants that can be read both in top down and bottom up perspective. On top and bottom left, respectively, the soft law of international sources, mainly the expression of non-conventional type of international institutions and without any legally binding effects and the soft law produced by market participants. On the other two quadrants, the prescriptive legislative source of supranational federal, state and prescriptive rules released and implemented by supervisors. In the financial sector soft law provisions can become \textit{de facto} compulsory for both public institutions and private market

\textsuperscript{40} M Lamandini, \textit{Il diritto bancario dell'Unione}, in Scritti sull’Unione Bancaria, Quaderni di ricerca giuridica della Banca d’Italia, July 2016, n. 81.

players\textsuperscript{42}. The latter occurs, for instance, when a supervisory authority considers self-regulatory best practices as a decisive factor in assessing financial institutions’ compliance with general principles of supervision like safe and soundness, fairness or transparency\textsuperscript{43}.

Rule-making is a dynamic process whereby rules move frequently from one quadrant to another, enriching the content and adding to it at each transition. Such a paradigm is premised on the idea that the regulatory space should be composed by ‘knowledge-based’ actors. Hence, the regulated industry is likely to maintain a position of ‘authority’ in governance in the post-crisis landscape, by virtue of the set of information they possess. The regulatory wheel could be said to be dominated by knowledge-based individuals and communities whose collective role provides a form of governance that is perceived as legitimate and credible because of the knowledge base, professionalism and rationality in operation and action. Hence it is likely to have the authority to participate in governance\textsuperscript{44}.

4. What is the role of private regulation in achieving social-economic goals relating to the banking industry? A general introduction to “new governance” theory

Ensuring effective EU financial regulation in overcoming market failures (including excessive fragmentation of the internal market as such) is not only a function of the risks involved\textsuperscript{45}, but also of the information and engagement

\textsuperscript{42} In this respect, the ECJ recently held that guidelines or recommendations issued by the ECB to national competent authorities (NCAs) can be considered as having legal effects whenever the NCAs feel somehow obliged to abide by these guidelines and recommendations or, differently said, if such is “the perception of the Policy Framework on the part of the euro area Member States’ regulatory authorities”. See Judgment of the General Court, T-496/11, 4 March 2015, United Kingdom v. ECB, par. 42.

\textsuperscript{43} The former materializes in situations like the one so neatly described by Article 6 of Directive 2013/36/UE where it reads: “Member States shall ensure that the competent authorities make every effort to comply with those guidelines and recommendations issued by EBA in accordance with Article 16 of Regulation (EU) No 093/2010 and to respond to the warnings and recommendations issued by the ESRB pursuant to Article 16 of Regulation (EU) No 092/2010”.


that each market player can provide. Even when risks are high, and so are the potential market failures to overcome, EU banking law seems to favour a flexible regime of co-regulation, which foresees the engagement of a variety of parties. This regime consists of relatively ‘light’ substantive rules (primarily about the regulatory objectives, complemented by some common principles, the layers of conformity assessment when using European standards and some administrative arrangements plus a safeguard clause) complemented (and influenced) by private initiatives.

The approach hinges on a regulatory framework that is not excessively prescriptive and which sets out certain objectives to be obtained. Such a regulatory strategy has been recently referred to as “meta regulation”, in that regulators provide a broad framework which allows regulated entities to implement systems and processes to achieve the regulatory objectives.

Looking at the financial legal order, Talbot maintained that “principles-based regulation, meta regulation, risk-based regulation, reflexive regulation and gatekeeper regulation all apply, in an attempt to deliver a cooperative private-public rule-making and supervisory environment”. This in turn implies the involvement of multiple actors along the different stages of the law-making process (legislation, rule-making, implementation and enforcement). In so doing, policymaking evolved from a centralised “top-down” ordering process,

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48 L. Talbot, Progressive Corporate Governance for the 21st Century, Routledge, 2013, 148ff., where also the complementing observation that “meta regulation is a form of enforced self-regulation (...) and involves the regulator delegating authority to the regulated to design its own standard setting and mode of compliance, which is overseen by the regulator” (p. 151); reflexive regulation implies in turn that “those regulating the self-regulation of others may subsequently have their role concretised in law and give statutory authority” (p. 152) and gatekeeping regulation “involves a focus and engagement with those who are not regulators and who are not regulators themselves but have a strategic position over those who are, which enables them to exercise influence or control over them” (p. 152).
to a “de-centralised”, multi-level process, well described as a “process of mutual problem-solving among stakeholders from the government and the private sector”.

Such a “de-centering governance” tendency is reflected in the main tenets of new governance theory, which provides theoretical support for increased reliance on self-regulation and shared governance roles in the financial industry sector. Such co-governance models are based on the principle of “co-opting the industry to govern itself”, insofar as this is necessary in order to achieve regulatory objectives.

Socio-legal scholars have in fact contributed to a rich new governance literature regarding the evolving methodologies and tools of governance. The central principle of new governance literature posits that traditional “command-and-control”, “top-down” regulation has been replaced or integrated, to varying degrees, by new forms of collaborative governance which emphasizes a dynamic cooperation between public (governments, regulators) and private (regulated) parties. Such a view is in stark contrast to that of public choice theorists, who typically frame private involvement as a threat to a proper administrative process, emphasizing the risks of strategic manipulation and describing policy choices as a product of pressure on the part of well-organised and powerful private actors.

New governance theory conceptualises that regulatory effectiveness and enforcement depends on the tools through which governance is effectuated,


focusing therefore on the regulator-regulatee mode of interaction. It is hence a strategy that can coexist with traditional administrative activity as a complementary tool to respond to increasing complexity of modern forms of social organisations\textsuperscript{53}. New governance refers to a wide range of administrative governance regulatory techniques and tools that all share some defining features: increased participation of, and power sharing with, private actors; public adoption of rules negotiated by non-state stakeholders; promotion of competition and diversity as a structural component of regulation; dynamic, responsive and dialogic law-making process as a response to dynamic regulated markets; composite and multi-level legal ordering; use of broad legal frameworks integrated by flexible, revisable rules and standards\textsuperscript{54}.

The common thread of all new governance initiatives is thus the deployment of innovative modes of interaction and techniques to overcome intractable market failures which are not solvable by adopting a traditional command and control regulatory model alone. In that respect, legal scholarship has qualified three main characteristics as being the most relevant to regulatory reforms in dynamic and complex financial markets: i) retention of a public role in law-making and enforcement; ii) active pursuit of private actors’ knowledge to supplement; and iii) a dynamic, flexible and dialogic law-making process\textsuperscript{55}.

The first characteristic refers to the retention of formal public authority, even if private initiative is involved. According to new governance theory, in fact, there must always be some element of public administrative ordering, even if it operates in the background. This precondition has been qualified as a jurisdictional requirement as to mitigate the central accountability challenge associated with new governance paradigms\textsuperscript{56}. So, a purely private ordering – such a deregulation regime – is not to be regarded as a form of new governance regulatory technique. The retention of a “last-say” and residual command-and-control powers has been vividly depicted as “a benign big gun” in the


\textsuperscript{54} For a precise list of attributes see R Weber, \textit{New governance, financial regulation and challenges to legitimacy: the example of the internal models approach to capital adequacy regulation}, Administrative Law Review, 2010, 62, 783. The author warns that no new governance tool draws on all these characteristics.

\textsuperscript{55} \textit{Ibidem}.

hands of regulators. Ian Ayres and John Braithwaite had metaphorically used this image to refer to the background threat of some – rarely deployed, but available – severe sanctions. Regulators wield “moral persuasion” which prompts regulated actors’ behaviours, eventually incentivizing them to avoid drifting away from the regulatory objectives\(^57\). The presence of the public authority in the background is projected to motivate socially responsible conduct by the regulatees, prompted by the threat of government intervention and often meant to pre-empt it\(^58\).

The second feature of new governance measures relates to the information in the hands of private actors. By including non-state participants to the law-making process, they strive to bridge the informational gap between regulators and regulated entities. More specifically, such a collaborative form of governance aims at harnessing the expertise and knowledge of private actors to serve public goals. In order to do so, the traditional administrative law paradigm is to be adjusted as to foster a trustworthy atmosphere and a consensus oriented interaction between public and private actors\(^59\).


\(^58\) Such an approach has been recently shared by innovative regulatory strategies such as nudging and empowerment. Behaviourally informed regulation is a set of tools aimed at taking over ineffective traditional ones whenever the main objective of regulation is a change of individual behaviour. This regulatory strategy is designed to prompt certain behaviour, and does so in a way as to exploit the emotional responses of individuals or to enhance people’s capacity to adopt deliberately conscious decisions without directly pushing action toward a desired direction: see R Van Bavel, B Herman, G Esposito, A Proestakis, *Applying Behavioural Sciences to EU Policy-making*, European Commission, Joint Research Center, Scientific and Policy Reports, 2013, available at http://publications.jrc.ec.europa.eu/repository/handle/JRC83284; L Bovens, *Real Nudge*, European Journal of Risk Regulation, 2012, 3(1) 43–46; Y Feldman and O Lobel, *Behavioural Tradeoffs: Beyond the Land of Nudges Spans the World of Law and Psychology*, in A Alemanno and A-L Sibony (eds), Nudge and the law, Bloomsbury, Hart publ., 2015, 301–324.

\(^59\) J Freeman, *The Private Role in Public Governance*, NYU Law Review, 2000, 75, 549. Trust is also the premise for principles-based regulation, see i.e. J. Black, *Forms and Paradoxes of Principles Based Regulation*, LSE Law, Society and Economy Working Papers 13/2008. In a principles-based setting, the Author emphasises that “The relationship moves from one of directing and controlling to one based on responsibility, mutuality and trust. Regulators and regulatees move from a directing relationship of telling and doing, to a relationship in which regulators communicate their goals and expectations clearly in principles and apply those principles predictably, regulatees adopt a self-reflective approach to the development of processes and practices to ensure that these goals are substantially met, and, critically, both trust each other to fulfil their side of this new regulatory bargain“.
The third defining element of the new governance theory envisages flexible and dynamic styles of regulation. This feature brings up considerations relating to the general theories of regulatory approaches.

Most of the debate on style and approaches of regulation focuses on the dialectics between principles- and rules-based approaches (often simplistically referred to as a “trade-off”). At its simplest, a principles-based approach sets out general objectives to be achieved while leaving the choice of form and methods for achieving these objectives to the firms. A rules-based regulatory regime, by contrast, prescribes detailed individual rules, laying down the precise conduct which firms are required to adopt and perform.

The principles vs rules tension represents one of the most enduring dialectics in all of legal thought in terms of determining the optimal legal strategy to achieve regulatory goals. In that respect, legal and economic scholars alike have attempted to differentiate between rules and principles on the basis of, inter alia, their general or specific style, their temporal orientation, the degree of discretion which they confer upon regulated actors, and the position they occupy within the hierarchy of norms. The largely binary nature of this debate (i.e. “trade-off”) is likely to misrepresent that, in reality, rules and principles are but endpoints of a spectrum. However, they are still commonly adopted – despite the simplification – to describe the advantages and disadvantages of the two extreme approaches and then to set a hybrid regulatory response accordingly.

66 A rules-based approach aims to increase certainty and predictability, for regulators and regulated entities alike. For the former, it ensures to have set a clear objective to be achieved, for the latter it is easier to estimate the compliance costs. On the other hand, principles-based regulation moves from a directing relationship of telling and doing between regulators and regulatees to a relationship in which regulators communicate their goals and expectations, and regulatees are entrusted with the responsibility to
A key benefit of principles-based regulation is that it can potentially be applied to a sector that is undergoing rapid change without regularly adapting the regulatory framework itself.

For regulated entities, principles-based regulation is commonly deemed to facilitate innovation and thus enhance competitiveness. For regulators, it can provide them with flexibility, facilitate regulatory adaptation in the methods of supervision adopted; enable the regulatory regime to have some durability in a rapidly changing market environment; and enhance regulatory competitiveness. However, principles-based regulation is very demanding in that it requires both a regular interaction between the regulator and the regulated institutions and a great deal of trust between them.

Lately, the dialectic rules versus principles have been pushed forward and recast in terms of the “transaction and social costs stemming from 1) the generation of legal norms, 2) their subsequent application by decision-makers, and 3) the resulting incentive effects on those subject to their application.” If adopt processes and practices that ensure that these goals are substantively met: For a synthesis, see the landmark contributions of Julia Black, who also further references: J Black, The rise, fall and fate of principles-based regulation, in K Alexander, N Moloney (eds) Law Reform and Financial Markets, Cheltenham, Elgar Financial Law Series, 2011, p. 3. For a detailed account of risk-based regulation, see also J Black, The development of risk-based regulation in financial services: just modelling through?, in J Black, M Lodge, M Thatcher (eds), Regulatory innovation, A comparative Analysis, Cheltenham: Edward Elgar, 2005, 156; J Black, Regulatory styles and supervisory strategies, in N Moloney, E Ferran, J Payne (eds), The Oxford Handbook of Financial Regulation, Oxford: OUP, 2015, 218 (offering a comprehensive and insightful review of regulatory styles).

67 J Black, Forms and Paradoxes of Principles Based Regulation, LSE Law, Society and Economy Working Papers 13/2008. The FSA itself puts forward cogent reasons for adopting PBR which is in accord with the advantages of principles often noted in academic commentaries. It offers four main reasons for adopting a more principles based approach. Firstly, effectiveness: detailed rules, it argues, have been incapable of preventing misconduct in a range of areas, such as misselling of retail financial products. Secondly, durability: regulation that a focus on outcomes is more able to adapt to a rapidly changing market environment than one which is based on prescriptive rules. Thirdly, accessibility: principles are far more accessible to senior management and smaller firms in particular others than a bewildering mass of detailed requirements. Fourthly: fostering substantive compliance: a large volume of detailed provisions can divert attention towards adhering to the letter rather than the spirit of the rules, making it less likely that the FSA will achieve its regulatory objectives.


we take this perspective, typically the generation of detailed rules will result in
greater ex ante transaction costs attributable to the time and effort expended by
drafters, in order to articulate the empirical substance of triggers and to match
this trigger with the appropriate legal response70.

When regulating dynamic and complex market behaviour, though, traditional
“rule-principle polarity thinking” ends up producing either over- or under-
inclusive rules, failing thus to achieve the regulatory objectives71. Worse still, it
might result in unexpected consequences which contribute in exacerbating
market complexity, and eventually igniting market failures. Either way, an ex-
ante rule or principle is very unlikely to be construed as to keep up with the
dynamism of modern financial intermediation72. In that respect, indeed, Chris-
tie Ford notes that a highly complex and dynamic scenario, especially as
characterised by regulator-regulatee information gaps, is susceptible to neither
rules (due to the information asymmetries) nor principles (because of the
incapacity of capturing frequently occurring transaction events), but more
likely an intermediate juncture between the two.

New governance scholarship gets around such theoretic dilemma by focusing
on the way the regulatory tools (whether they consist of rules or principles)
are designed to achieve the objectives in a de-centralised and dynamic market-
place. Thus, from a new governance perspective, principles or rules based
regulatory techniques are to be studied as components of flexible legal systems
which are open to diverse forms of articulation. Regulatory effectiveness and
enforcement is to be sought by focusing on the regulator-regulatee mode of
interaction and the tools through which governance is effectuated. Such differ-
ent forms of articulation should capture the rapid expansion of what Lawrence
Lessig referred to as “architecture”73 — the code, protocols, platforms and
structures that determine how firms, consumers and policy- and law-makers
interact —, which raises indeed a number of legal and societal issues. Regula-
tory engagement with the financial system ought to take into account that the
industry itself — as a nexus of parties — has confronted expansive change over
time, and that the infrastructure and the modes of interactions are therefore

70 RB Korobkin, Behavioral Analysis and Legal Form: Rules vs. Standards Revisited, 79
Or. L. Rev. 23, 26 (2000).
71 For some evidence in the wake of the financial crisis, see. i.e. C Ford, Principles-Based
Securities Regulation in the Wake of the Global Financial Crisis, McGill Law Journal,
2010, 55, 257.
72 LA Cunningham, A Prescription to Retire the Rhetoric of „Principles-Based Systems“,
Corporate Law, Securities Regulation, and Accounting, Vanderbilt Law Review, 2007,
60, 1481-1491, stresses the “temporal division between rules, the content of which is set
out ex ante, and principles, the content of which is filled in ex post”.
relevant parameters against which to assess the effectiveness of the regulatory policies.

5. Defining features of recovery and resolution planning (“living wills regulation”)

Along the wave of financial regulatory reforms spurred by the GFC, the advent of recovery and resolution planning (the so called “living wills regulation”) has been welcomed as “one of the few genuine innovations”. Not only does it mandate banks to outline plans to be incorporated into regulation and supervision practices, but it envisages, most importantly to our mind, new modes of interaction between regulators and regulatees.

Living wills regulation has indeed become a key instrument in many jurisdictions in order to minimise costs to taxpayers and prevent “bail-outs”, as well as to help limit and counteract the externalities that generally accompany bank and financial failures.

In the U.S., the Dodd-Frank Act requires systemically important banks to submit a resolution plan that sets forth how the firm would liquidate in an orderly manner to minimize any systemic impact (Dodd-Frank Act, § 165

74 In that respect, Julia Black proposes a “conversational model of regulation” as to solve the inherent uncertainty, indeterminacy, and over- or under-inclusiveness of regulatory rules and principles (see J Black, Rules and Regulators, 1997, 37–44.


76 The development of living wills regulation has been prompted by some influential recommendation put forth by international standard setters, most notably the Financial Stability Board: see FSB, Key Attributes of Effective Resolution Regimes for Financial Institutions, 4 November 2011, available at http://www.fsb.org/wp-content/uploads/pr_111104dd.pdf?page_moved=1. The proposed measures are comprised of four key building blocks: (1) Strengthened national resolution regimes that give a designated resolution authority a broad range of powers and tools, including statutory bail-in, to resolve a financial institution that is no longer viable; (2) Cross-border cooperation arrangements in the form of institution-specific cooperation agreements, underpinned by national law, that will enable resolution authorities to act collectively to resolve cross-border firms in a more orderly, less costly, way; (3) Improved resolution planning by firms and authorities based on ex ante resolvability assessments that should inform the preparation of Recovery and Resolution Plans; and (4) Measures to remove obstacles to resolution arising from complex firm structures and business practices, fragmented information systems, intra-group transactions, reliance on service providers and the provision of global payment services.

77 TF Huertas, RM Lastra, Living Wills, in Banco de Espana, Estabilidad Financiera, 2011, n. 21, p. 25.
On the other side of the ocean, the U.K. has been particularly proactive in advancing the policy and regulatory concept of living wills, which was first proposed in January 2008 in a Treasury consultation paper entitled “Financial stability and Depositor Protection: Strengthening the Framework”79. The UK Financial Services Act 2010 indeed provides for the regulator to require financial institutions to draw up ex ante “recovery and resolution plans” in order to set out how they would deal with a potential crisis80.

Living will regulation has also found favour in EU policy-making and is now part of the set of measures embodied in the ambit of banking crisis management.

EU recovery and resolution planning for financial institutions are both regulated in Directive 2013/36/EU (CRD IV) and Directive 2014/59/EU (BRRD). And indeed, recovery plans dwell at the intersection of these two pieces of legislation. They are to be regarded as a governance arrangement within the meaning of Article 74 of Directive 2013/36/EU in that they are for the bank to develop and “own”. Such a tool is comprised within the set of internal arrangements, processes and mechanisms of the financial institutions.

Recovery plans basically aim to reduce the likelihood of failure by requiring banks to identify options in order to achieve recovery when a crisis occurs. The purpose is therefore to enable banks to outline the steps they could take to recover from severely adverse situations and conditions that could cause their failure.

Despite being rightly qualified as an internal governance component, recovery plans are materially and extensively regulated in the BRRD. They are a private internal measure which connects to the public objectives enshrined in the Banking Recovery and Resolution Directives, namely ensuring “the continuity of the financial institution’s critical financial and economic functions, while minimising the impact of an institution’s failure on the economy and financial system” (see Recital 5). Recovery plans are but a “menu of options” (way-
outs) for dealing with a range of increasingly distressing scenarios. They “include appropriate conditions and procedures to ensure the timely imple-
mentation of recovery actions as well as a wide range of recovery options. Member States shall require that recovery plans contemplate a range of scenar-
ios of severe macroeconomic and financial stress relevant to the institution’s specific conditions including system-wide events and stress specific to individ-
ual legal persons and to groups.”

Recovery plans amount to a delegation of clearly defined quasi-regulatory duties to closely regulated agents, in that they allow self-regulatory initiative based upon, and clearly constrained by, directive provisions. Section A of the Annex attached to the BRRD lists the minimum information to be included in the recovery plans and the European Banking Authority, in close cooperation with the European Systemic Risk Board (ESRB) who are required to issue guidelines to specify further the range of scenarios to be used for the purposes of setting up the internal procedures. Additionally, such planning is to be updated at least annually and assessed and approved by the authorities, which therefore retain some monitoring and scrutiny power upon them.

Resolution plans, on the other hand, are prepared not by the firms themselves, but by the authorities. Nonetheless, the plan is based on a detailed resolution analysis to be submitted by the bank as to determine resolution tools and ways to ensure the continuity of critical functions. In that respect, recovery and resolution plans are strictly interdependent, the latter being based on the information provided by the former. Indeed, resolution planning takes account, inter alia, of how critical functions and core business lines can be legally and economically separated from other functions as to ensure continuity in the event of the failure of the institution; a detailed description of the assessment of resolvability, a description of critical interdependencies; an analysis of the impact of the plan on other institutions within the group; a description of the options for preserving access to payments and clearing services and other infrastructures and so forth.

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81 See art. 5(6), BRRD.
82 See art. 5(2), BRRD.
83 The resolution procedure revolves around the criterion of the public interest, which is one of the three conditions to be satisfied for a bank to be put into resolution (see art. 32 BRRD, art. 18 SRMR). Before determining the “preferred resolution strategy” (PRS), indeed, the public interest criterion should be ascertained, as it represents the parameter against which to define and implement the resolution plans (see European Banking Authority, EBA final draft Regulatory Technical Standards on the content of recovery plans under Article 5(10) of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms, 18 July 2014). If there is no public interest attached to the resolvability of the bank, the national insolvency
The overall aim of living will regulation is not only the development of a pre-packaged resolution or bankruptcy by the firm itself. It rather intends to provide the authorities with the necessary information concerning the details of the bank structure and to enable the authorities to form opinions on its resolvability84. These plans outline arrangements and measures to enable the supervisory and resolution authorities to take early action to restore the bank’s long viability in the event of a material deterioration of its financial situation.

The objective of living wills regulation is therefore two-fold: one purpose is to force the firm to think about its own resilience in times of trouble; the other, and even more important one, is to provide supervisory authorities with the necessary information enabling them to take the right measure at the right time85. So, recovery and resolution planning have both an *ex ante* and *ex post* element to them: they are directed at identifying rescue scenarios for institutions running into troubles, taking action as early as possible; but they are also aimed at providing a credible means of resolution should the bank fail.

Economic and legal scholarship alike emphasise the relevance of living wills regulation when dealing with complexity in financial institution organisation, financial market structures and networks88. Living wills act as a structural simplification which contributes towards reducing excessive complexity and could entail a general risk moderation in the financial sector, since financial institutions are compelled to think about how their structure can be made simpler89. In that respect, we contend that new governance theory might be

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informative in better understanding the modes of interaction as required by living will regulation. Recovery and resolution planning measures allow private initiatives to integrate the traditional “uniform-rules-of-general-application” approach by incorporating regulated institutions’ internal models and plans into crisis management regime.

6. Recovery and resolution planning in a “new governance” perspective

Financial regulators face chronic and potentially severe asymmetries of information and expertise vis-à-vis regulated actors. These asymmetries are the products of, inter alia, i) high-powered economic incentives unique to regulated actors to invest in the acquisition of information and expertise, and ii) incomplete and often less than timely access by regulators to market and firm-specific information90.

Since the effectiveness of crisis management regulation depends on the ability to promptly intervene with the appropriate measures, this complexity paradigm, which entails a dynamic and proliferating risk profile, presents a fundamental dilemma for regulators. In response to this dilemma, financial regulators have in recent years sought to incorporate private regulation as a means of bridging the informational gap between the actual risk profile of regulated firms and the regulators charged with minimizing the social costs incurred if those risks materialize.

In contrast to the traditional legal-centric paradigm, living will regulation is premised upon an iterative, dialogic, “conversational”91 relationship within which regulated actors are invited to play a potentially important role within the process of generating regulation. Living will regulation is thus a reflection of the new governance theory which envisages a hybrid form of private-public regulation92.

Living will regulation resembles mutatis mutandis the regulatory technique devised for internal ratings-based approach (IRB) and internal control system.


On the one hand, Robert F. Weber convincingly demonstrates how regulators adopted internal model approaches as a means of more closely calibrating capital requirements to the actual risk profiles of banks, which had become increasingly complex over time. He approaches capital adequacy regulation by applying the new governance theory as an analytical framework. He advocates for new modes of interaction between public- and private-actors in overcoming the flaws stemming from a solely “top-down” prescriptive risk-weighting approach.93

On the other hand, Iris H-Y Chiu puts forward strong arguments in favour of a regulatory approach that empowers and enhances the capacity of financial institutions to self-regulate (“meta-regulation”) their internal governance measures. This is a form of delegated governance by regulators to banks, and banks can have considerable discretion in designing the implementation systems and processes. As she maintained, “regulatory interest in the institution of internal control at banks and financial institutions lies in its organisational position and role. Internal control has proximity to inside knowledge and issues, and acts as an internal gatekeeper for banks and financial institutions. It may be argued that such an organisational position and role could also serve the regulator’s objective of securing the financial institution’s compliance with regulatory requirements. In other words, internal control is increasingly being fashioned as an internal gatekeeper which serves gatekeeping purposes for the regulator”94.

Likewise, the design of living will regulation appear to be construed on a calibrated interplay between regulators-supervisors and regulated-supervised entities. External regulation (hard law) is used to induce private actors to contribute (self-regulation) in achieving outcomes that would not have been obtained if it had been solely based on a top-down, command and control, approach. Nor would they have been obtained if the private actors had been allowed to engage freely in market activities, without any forms of public check-and-balance and retention of powers.

Such a hybrid nature resembles the distinction made by Dan Awrey between “substantive” and “technological” content of principles-based regulatory measures. “The substantive content of a principle is collectively made up of the animating principle itself (e.g. “a firm must conduct its business with integrity”), the statutory construction of any norms giving effect to this principle

94 I H-Y Chiu, Regulating (From) the Inside. The Legal Framework for Internal Control in Banks and Financial Institutions, Hart Publishing, 2015, 3-34.
(e.g. anti-fraud provisions), the interpretive assumptions underpinning this statutory construction (such as the common law definition of fraud) and, importantly, the desired regulatory outcomes (e.g. the promotion of confidence in financial institutions and markets). The technological content of a principle, on the other hand, consists of the policies and procedures implemented by regulated actors for the purpose of achieving desired regulatory outcomes”.

Indeed, recovery and resolution planning envisages that the responsibility for articulating the general outline (or “substantive content of principles”) resides with regulators, whereas the internal procedures (“technological content”) is conceived to be generated by the regulated actors. Furthermore, such a mode of interaction contemplates that regulators will leverage the information and expertise of regulated actors when generating and updating substantive content95.

This symbiotic relationship between “external” regulation and “internal” regulation is premised on a clear articulation between regulators/supervisors and private actors. The former is called upon to set forth rules that identify the regulatory outcomes (or desired behaviours) they are designed to achieve (or incentivize), without prescribing the detailed procedures with which regulated actors are expected to comply96. This is reflected in the presumption that, on the other hand, regulated actors are better positioned and informed than regulators to determine the technological content of the policies and procedures necessary to achieve desired regulatory outcomes97.

95 See C Coglianese and D Lazer, Management-Based Regulation: Prescribing Private Management to Achieve Public Goals, Law and Society Review, 2003, Vol. 37, 691–730. Available at SSRN: https://ssrn.com/abstract=487182. They analysed a regulatory approach that they call “management-based regulation”. Management-based regulation directs regulated organizations to engage in a planning process that aims toward the achievement of public goals, offering firms flexibility in how they achieve these goals. Management-based regulation can be an effective strategy when regulated entities are heterogeneous and regulatory outputs are relatively difficult to monitor. Yet, it requires a far more complex intertwining of public and private sectors than is typical of other forms of regulation, owing to regulators’ need to intervene at multiple stages of the production process as well as to the degree of ambiguity over what constitutes good management.

96 “Effective compliance will evolve away from a primary focus on the designing, implementing and monitoring processes that embed detailed regulatory rules in business operations. Instead, it will increasingly require the exercise of judgment.”: FSA, Principles-based Regulation: Focusing on Outcomes that Matter (April 2007) and J Black, M Hopper and C Band, Making a Success of Principles Based Regulation (2007), Law and Financial Markets Review p. 193.

97 As explained by C Briault, Making a Real Difference to Consumers Through More Principles-Based Regulation, FSA, Treating Customers Fairly Conference (December 7, 2006), the FSA’s principles-based approach involves “a shift of emphasis... away from
Each financial institution is in fact required to draw up and maintain “a recovery plan providing for measures to be taken by the institution to restore its financial position following a significant deterioration of its financial situation” (art. 5, BRRD). This also means that primary responsibility for crisis management rests with market participants, since financial institutions are delegated to develop internal governance arrangements as to restore viability. On the other hand, recovery planning serves a governance function in the overall financial regulation agenda in that it secures the attainment of regulatory objectives.

Indeed, recovery and resolution planning appears to include the main characteristics of the new governance programs and tools. It contemplates: i) retention of a public role in law-making and enforcement; ii) active pursuit of private actor’s knowledge to supplement; and iii) a dynamic, flexible and dialogic law-making process (increased participation of, and power sharing with, private actors).

Recovery plans are indeed the result of a conversational and dynamic interaction, whereby private involvement is analytically framed as to reach regulatory objectives. They are an expression of the fundamental rights of property and of freedom of enterprise, in that they are to be qualified as internal governance measures. Such freedom of enterprise seems to bring up a new host of regulatory challenges, as pointed out in the recent Grande Chamber judgement of the ECJ in Tadej Kotnick98. Yet, they shall include at least the information listed in section A of the Annex to BRRD and supervisors have the power to require institutions to update their recovery plans. The retention of public authority is therefore relevant and formally confined to prompting financial institutions to revise their plans. In fact, this power is to be read in conjunction with financial institutions’ responsibility to update their recovery plans regularly or after a “change to the legal or organisational structure of the institution, its business or its financial situation, which could have a material effect on, or necessitates a change to, the recovery plan” (art. 5, par. 2, BRRD). These measures, meant to restore viability of the failing entity, are, and remain, private initiatives, yet under the “benign gun threat” that supervisors step into the material and substantive internal regulation which a firm has adopted.

98 See C-526/14, Judgement of 19 July 2016. Despite the case being about resolution measures (instead of recovery measures) adopted by a national competent authority before the implementation of the BRRD, the Court discussed the tension between property rights and freedom of enterprise and public interests based on grounds of soundness and stability of the financial market.
On the other hand, however, *ex post* intensive supervision and vigorous enforcement are essential components of this regulatory strategy, too. Not only is public authority to be retained *ex ante*, it is needed to identify and punish those un-cooperative credit institutions whose wilful misconduct would otherwise threaten to erode the mutual trust the new governance theory is premised upon\(^9\). In cases where competent authorities detect deficiencies or impediments to the implementation of a recovery plan, or resolution authorities find that there are substantive impediments to the resolvability of the institutions, the authorities are empowered to (re)direct the institution to implement a series of measures to facilitate the implementation of the recovery plan, or the resolvability of the institution, e.g. a reduction of the risk profile, recapitalisation, review of the strategy and structure, changes in the funding strategy, or the governance structure (art. 6, BRRD)\(^10\).

The supervisory practices therefore have to be characterized both by “a high frequency of interactions and high levels of expertise and independence on the part of supervisors – facilitate greater information flow between regulators and regulated actors and provide a built-in feedback mechanism for communicating regulatory expectations in a non-public, non-adversarial fashion”\(^11\). Insofar as living wills regulation contemplates the devolution of responsibility for the generation of internal models and plans to deal with the financial deterioration, intensive supervision and the credible threat of enforcement are necessary in order to ensure the greatest possible congruence between private incentives and public regulatory objectives\(^12\). As stated from the outset, in fact, private actors are co-opted to cooperate and this dialogic interaction should not be mistaken for a complete devolution of self-regulatory powers to supervised entities. The retention of a significant public role for supervision and enforcement also serves to distinguish this regulatory approach from forms of uncon-

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\(^10\) More controversially, in terms of intrusive new supervisory powers, to facilitate resolvability resolution authorities can dictate measures that include the revision of intragroup financing, or service agreements to covert the provision of critical functions, limits to individual and aggregate exposures, information requirements, orders to limit or cease specific activities, business lines or products, changes in operational structures to segregate critical functions, changes in corporate structure (e.g. the setting up for a parent holding company, or a separate holding company for the banking business within a conglomerate), or the issuance of liabilities eligible for bail-in.


strained self-regulation (along with light-touch supervisory practices), which were popular in the pre-crisis era. Increased participation and power-sharing allows structuring collaborative solutions to complex market imperfections. Recovery and resolution planning mainly corrects three types of market failures: i) the bounded rationality problem, since it forces the firm’s managers to think through and more clearly confront the reality of the firm’s possible failure; ii) agency failure and information failure, because it indirectly motivates the firm’s managers to consider how they can better govern the firm to avoid liquidation; and, responsibility failure (or moral hazard) by motivating firms to operate responsibly without reliance on the corporate reorganization protections of bankruptcy law.

Advantages to this regulatory approach include reduced likelihood that supervisors and supervised entities will not be prepared to deal with economic and financial pathologies. Recovery and resolution planning not only aims at preventing a crisis from happening, but also to shore up the system, should a crisis materialise. The consequence is that systemically important firms should be less likely to fail and, if they do fail, should be less likely to externalize systemic costs.

7. Concluding remarks

The trajectory of financial regulation is very much based on cooperative modes of interaction between private and public actors. New governance theory and scholarship posits that such cooperation between “regulators” and “regulated entities” is indeed essential to cope with the dynamism of modern financial intermediation. Along with internal ratings and internal governance measures, this article describes how living will regulation can be considered, in certain aspects, a new governance technique. Recovery and resolution planning aims indeed at overcoming market failures which would not have been remedied by solely traditional “top-down” regulatory strategies. Living wills’ objective is to minimize social costs associated with financial institution’s insolvencies. It achieves that goal through increased involvement of non-state actors in the regulatory process. This requires regulators to define the main regulatory objectives, to articulate the rules on a flexible and dynamic basis, to accept

104 On the concept of “resilience” see, i.e., the recent document released by the Financial Stability Board, FSB Resilience through resolvability – moving from policy design to implementation. 5th Report to the G20 on progress in resolution, 18 August 2016.
input from the ground level of regulated entities, and to effectively manage incoming information from industry actors.

The early stage of banking crisis management appears as a prolific terrain for public-private collaborative forms of regulation in line with the tenets of new governance scholarship. Greater interaction between regulators-supervisors-and regulated entities in this area seems to have a number of advantages over conventional “top-down” regulation, which, to our mind, is worth exploring further. By setting forth such a dialogic model of regulation, regulators and supervisors will likely be able to improve their diagnosis of sources of market dysfunction and deepen their understanding of complexity, market dynamics and business practices. By letting private actors draft their living wills, public actors are incorporating regulated institution’s internal models in the banking crisis management regime, thus bridging intractable information asymmetries resulting from the complexity and dynamism of contemporary financial institutions.