

Protecting the City of London? UK challenges before the Court of Justice of the European Union

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Since last year, I have reported on a number of challenges which the United Kingdom brought before the European Court of Justice. These challenges were directed against various EU measures which the UK felt were not in its national interest, or for that matter, the interest of the City of London. As a reminder, the challenges concerned:

- (i) a proposed financial transaction tax (ie, the Council decision authorizing closer cooperation between a group of Member States on a financial transaction tax);
- (ii) a provision – Article 28 – of the EU short selling regulation which vests the European Securities and Markets Authority (ESMA) with intervention powers;
- (iii) the so-called bankers' bonuses cap under EU capital requirements legislation; and
- (iv) the European Central Bank's location policy under which central counterparties that clear sizeable amounts of Euro denominated transactions were meant to be located in the Eurozone area.

I have reported on the three first challenges. None of them was successful from a UK point of view. It leaves me with one challenge to consider: the challenge – or better, the challenges – to the ECB's location policy. I am referring to 'challenges' because the UK brought three challenges before the General Court in relation to the location policy. I will focus on the one that was decided earlier this year. For reasons that I will explain later, there is no need to consider any of the other challenges.

The ECB's location policy concerns central counterparties (CCP). A CCP is a legal person whose purpose is to stand in between two parties to a financial transaction.¹ The role of the CCP is to make sure that if one of the original parties defaults, the contractual obligation owed to the non-defaulting party can be honoured. The location policy essentially requires CCPs which clear significant amounts of Euro denominated products to be located in the Eurozone area.² For the ECB, the objective of this policy, which incidentally had been left unimplemented for a number of years, was legitimate. A failing CCP is potentially a risk to financial stability. From the ECB's point of view, control over CCPs, which clear sizeable amounts of Euro denominated transactions, should therefore be located within the Eurozone area. For the UK however, the policy was a major concern. Specifically, the UK was concerned about the impact of the location policy on UK based clearing houses such as LCH.Clearnet which has a vast portfolio of euro-denominated business.³

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¹ See generally, C Pirrong, 'The economics of central clearing: theory and practice' (2011) 1 ISDA Discussion Paper.

² E.g. European Central Bank, 'Eurosysteem oversight policy framework' (July 2011) 10 <http://www.ecb.eu/pub/pdf/other/eurosysteemoversightpolicyframework2011en.pdf>.

³ A Barker, G Parker and J Grant, 'Britain to sue ECB over threat to City' (Financial Times, 14 September 2011).

The General Court ruled on the UK's first challenge to the location policy in March 2015.⁴ It decided in favour of the UK, ruling that the Eurosystem Oversight Policy Framework, in so far as it concerned the location policy, should be annulled. The UK clearly had a good case. It made some solid arguments before the General Court. *Inter alia*, the UK argued that the location policy did not square with the principles underpinning the internal market. The argument is worth highlighting here, because it is symptomatic of a wider concern in the UK about the potential impact which an increasingly integrated Eurozone might have on the internal market. Indeed, the idea that the internal market might be held hostage to the policies of a group of Member States which seek closer integration has been expressed by the UK in political fora as well. Thus, during the negotiations of the European Market Infrastructure Regulation (EMIR) which *inter alia* puts in place a regulatory and supervisory framework for CCPs,⁵ the UK also insisted on including provisions which underline the basic principle of non-discrimination and make it plain that discrimination against Member States as a place for clearing services 'in any currency' is not acceptable.⁶ Concerns over internal market fragmentation were also expressed during the negotiations over the Single Supervisory Mechanism, one of the pillars of the EU Banking Union. In response, the EU legislature adopted provisions which highlight the importance of safeguarding the 'unity' or 'integrity' of the internal market.⁷

Returning to the location policy challenge, the UK's focus on preserving free movement and the internal market was thus entirely consistent with the position that it adopted elsewhere as well. However, the General Court did not address the internal market law issue. Instead, it decided against the ECB on grounds of a lack of competence. Specifically, the General Court decided that the ECB did not have competence to regulate activities of securities clearing systems. It followed that the ECB was not competent to impose a requirement on CCPs to be located in the euro area. Arguably, by focusing on this competence issue, the General Court provided a simple solution from a legal point of view. Nevertheless, one can regret that the General Court did not have to examine the internal market problematic. The question of possible negative effects of Eurozone activities on common policies such as the internal market is likely to remain a cause for concern for Member States which do not wish to participate in closer integration. The UK's other 'location policy' challenges will not offer any additional insight either. The UK agreed to withdraw its remaining court cases after that the ECB and the Bank of England agreed on strengthening their relationship with a view to improving financial stability.⁸

⁴ Case T-496/11 *United Kingdom v European Central Bank*, (judgment of 4 March 2015).

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 L201/1.

⁶ Art 17(6) of Regulation (EU) No 648/2012. See also Rec (47); Rec (52) of Regulation (EU) No 648/2012.

⁷ e.g. Art 1, Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions [2013] OJ L 287/63.

⁸ European Central Bank and Bank of England 'European Central Bank and Bank of England announce measures to enhance financial stability in relation to centrally cleared markets in the EU' (joined press release, 29 March 2015) <http://www.bankofengland.co.uk/publications/Documents/news/2015/044.pdf>.