

**INTEGRATING
FINANCIAL SERVICES
REGULATION**

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**Exploring Some of the Challenges Posed
by the EU Data Protection Regime**

Solomon Osagie



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*Integrating Financial Services Regulation: Exploring Some of the Challenges
Posed by the EU Data Protection Regime*

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PREFACE

This book examines the development of harmonisation of regulation of financial services in the EU with particular regard to the data protection regime. I use two models of integration theory to examine the behaviour of nation states when they embark on any sort of geopolitical and economic convergence. The histories of these states in the case of the EU have made consensus and convergence difficult. Unsurprisingly therefore, a natural evolution towards supranational expressions of unity was always going to be difficult. I argue that unless there is a determined, articulated and defined approach, regulation of data protection will remain fragmented and will leave the integration of financial services uncertain. The book will address three main issues using the history of general regulatory development in financial services as a backdrop:

1. The challenges of integration generally in the EU;
2. The implications of a less harmonised and integrated landscape for the regulation of data protection in the financial services sector;
3. The potential for the GDPR and its implementation to resolve harmonisation difficulties.

I describe how the history of data protection regulation has been influenced by the contrasting narratives of privacy rights versus the desire to enable commercial activity to thrive. Using the two models of integration

theory, it is suggested that a failure to harmonise the regulation of data processing has left EU member-states able to assert national influence in the regulatory regime. This has left commercial organisations and other stakeholders with a legal framework that impedes the development of a single market. Harmonisation of financial services regulation must therefore actively include not just the eradication of domestic distortions of supranational intent that found expression in transpositions of the data protection Directive, but also it must as far as possible, disallow the opportunity to do so.

The GDPR addresses some of the issues by centralising interpretation, defining flow-downs and harmonising enforcement and regulatory provisions. Whilst this does not resolve all the opportunities for inconsistencies, it demonstrates that unless there is a determined effort to harmonise the law and practice in this area, the regulatory framework will remain unintegrated. It also proves that complete harmonisation is arguably not an absolute concept. Further it supports those elements of integration theory that insist that state expression is never completely avoidable.

It is acknowledged that the terms “data protection rights” and “privacy rights” can have different meanings (Kuner, 2012, p2) and so are not always synonymous. But for the purposes of this book and for the fact they sometimes overlap, these terms are used interchangeably here but should be approached with caution.

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NOMENCLATURE

Article 29 Working Party – WP29

CJEU – Court of Justice of the European Union

DP – Data Protection

DPA – Data Protection Authority

DPO – Data Protection Officer

EC – European Commission

EDPB – European Data Protection Board

EDPS – European Data Protection Supervisor

EMU – Economic and Monetary Union

EU – European Union

FSA – Financial Services Authority

GDPR – General Data Protection Regulation

LI – Liberal Intergovernmentalism

OSS – One Stop Shop

CHAPTER ONE

SOME DILEMMAS OF EUROPEAN INTEGRATION

1.1 Background and Introduction

This chapter looks at some aspects of integration theory to determine whether they can help identify patterns of behaviour that are common to the integration process when nation states come together to create a supra national institution. The chapter will argue that there is evidence of predictability in the behaviour of nation states when they attempt to transpose supra national interests and agenda over those of the state. This book is not an attempt to review integration theories other than to identify what they tell us about how states will behave when faced with the challenge of incorporating the interests of the union into the domestic arena. These are the sorts of challenges that have seen pan European Union legislation become obfuscated by the interests of member-states pitted against each other and then against the unifying authority itself. From the theories we can see evidence of the consistency of states behaving in accordance with state interests.

A lot of the studies on the integration of the EU focus on the history of the formation of the union ignoring some key concepts, theories and learning points along the way.¹ Whilst some of these studies can influence and

¹For example Hooghe & Marks (1999) focused on the dynamics of the EU integration process and the politics of the process; Zielonka (2006) also focused on the history of the process of integration and the challenges that the EU faced.

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shape understanding of some of the challenges of creating and developing a union of independent states, they sometimes ignore the fragmented and almost irreconcilable challenges along that path. Some of these challenges have found expression in regulations like those that govern data protection.

The European integration debate has also raised dialogue² about what is described as the EU's democratic deficit.³ This chapter accepts that it is difficult to attempt to strike a balance between the thrust towards integration on the one hand and the desire to maintain the integrity and sovereignty of the individual component states on the other. However, the analyses of some commentators often confuse some of the concepts of democratic theory by attempting to apply domestic democratic theory concepts to the EU. In the process they ignore the reality that these are often inapplicable to a multi-state institution. By attempting to analyse the EU as if it were a nation state, it is easy to begin to identify perceived deficiencies. For example, the lack of a harmonised approach to law making or the sort of democratic legislatures as exists in the member-states. Opposition to European integration is then supported by the fact that sovereignty and legislative authority should rest with democratic institutions that are situated in member-states. This chapter argues that the absence of state-like institutions at supra-national level is not detrimental to the creation of a supranational institution; further that focus on these national institutions is misconceived because they do not explain the interaction of multi-state institutions in the decision-making process. In other words, it is a misplaced anticipation to expect typical or traditional state behaviour to manifest at supranational level. The authority of the EU does not negate the sovereignty of member-states. In fact, closer examination of the arguments will suggest that it is national sovereignty that underpins the authority of the EU. Those states and commentators who resist all forms of EU harmonisation on the basis that it threatens national sovereignty are arguably mistaken.

This chapter does not propose to critique or develop theories on integration. Rather it will use two examples of integration theory to demonstrate that integration generally allows for the interests of the state to prevail over those of a supranational institution. The interests may arise

²Majone, *Dilemmas of European Integration*, p23.

³The description refers to criticism of the EU and its institutions as undemocratic in comparison to the structures and processes that exists in member-states.

from political, social or historical reasons. It is understandable therefore that cultural considerations and differences between members-states have affected the application of different regulatory regimes, which Howell⁴ argues are then sought to be uploaded to the EU.

Ernst Haas⁵ provides a very helpful analysis of the integration process describing it as one:

“whereby political actors in several, distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new centre, whose institutions possess or demand jurisdiction over the pre-existing national states”

Haas’ description is apt because it highlights certain perspectives that this book develops and the dilemmas that are raised by them. For example, that integration requires some sort of change of focus, attention and even loyalty from one jurisdiction to another.

Schmitter⁶ writes in similar terms, describing European integration as *“the process of transferring exclusive expectations of benefits from the nation-state to some larger entity. It encompasses the process by virtue of which national actors of all sorts ... cease to identify with their own national government and its policies”*. There are problems with this description even from a neo-functional view-point. The assumption about a wholesome transfer of allegiance for example is not supported by the experience of EU integration nor by integration theory generally.⁷

But the dilemma that this attack on sovereignty creates is often overlooked as is the impact of pointing distinct social and geographic entities to some sort of unified jurisdiction irrespective and regardless of the divergences that exists in such entities. This dilemma is not lost on some commentators. Bickerton (2012) notes for example the tendency in the process of integration to isolate important policy making procedures from the scrutiny of the democratic institutions that exist in member-states. This observation

⁴Howell (2000) *Discovering the Limits of European Integration: Applying Grounded Theory*.

⁵1958, p16.

⁶1971, p238.

⁷Neither Haas (1958) nor Schmitter (1971) cite any example of states transferring allegiance in such a wholesome manner as they suggest. The danger is that the assumption that there will be such wholesome transfer of power and legislative authority promotes antagonism to integration because it is the diametric opposite of state sovereignty.

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resonates very loudly in 21st century EU literature and forms a key plank of the challenge to its democratic credentials. Whereas there are democratic institutions in member-states that attest to democratic credentials and hold national governments to account, there is a paradox in an EU that creates some supra-national institution composed of independent states. But that paradox does not necessarily create an antagonism. It is not necessarily an attack on sovereignty because as Bickerton says what you find is the “... *concept of a member state ... where national power is exercised in concert with others*”.⁸

The debate about the democratic credentials of the EU, has also allowed a new representation of what sovereignty means in the face of a 21st century geopolitical union, and if we accept that socio political theories will evolve, the suggestion that integration will detract from concepts like independence and sovereignty does not seem irrefutable.

Another problem with Haas’ definition is that it focuses on the political whereas for the EU, integration has advanced beyond this traditional meaning. Whilst this book does not purport or intend to rely on what Wiener and Diez⁹ explain as the broader aspects of integration theory (which includes theoretical approaches that are too restrictive), it will focus on context specific experiences which help explain behaviour and approaches to decision making in areas like regulation. In the regulation of financial services for example, it is possible to identify specific areas where integration has been problematic but yet partially successful. This success has been possible even when states have not transferred power or allegiance completely; it has occurred sometimes in areas where common interests have caused states to act in concert.

Whilst there are dilemmas in integration that stem from differences, we can rely on Howell’s Regulation Scale¹⁰ to show that financial services regulation is historically fragmented and that compromise has helped construct a shared approach which still has some inconsistencies. On reflection it may be concluded that the inconsistencies were predictable in the evolution of a supranational entity. Therefore, the EU should be more proactive in managing the interaction between its members in order to avoid or at least manage some of the negative inevitabilities of integration.

⁸2012, p4.

⁹2009, p3.

¹⁰Europeanization, European Integration and Financial Services, pp108–109.

To understand how states behave or are likely to behave when they attempt to formulate supranational institutions we can look to some of the theories on integration. Whilst they are relevant in predicting how states will shift their allegiance during integration, theories do not always explain why they do so. Some of the commentary is contradictory—for example the claim that integration focuses on the power and authority of the centre whilst diluting the authority of the state. Yet there is the reality that states will modify their behaviour when it suits them and are therefore able to determine their individual responses to supranational issues. This is important because it allows an enquiry into the consistency of state behaviour, whether we can expect a unified approach to EU regulation. Integration theory seems to suggest that this is not the case and therefore that we can predict how states will behave during the integration process.

1.1.1 *Selected Theoretical Approaches to the Study of Integration*

European integration was always going to be difficult to achieve. Hulsse¹¹ describes the EU as a novel entity. It is not a traditional geopolitical monolithic union because it has a conglomeration of decision making structures making it a rather unique post-modern institution, a kind not replicated elsewhere. This construction which engenders dialogue about identity—national versus supranational—and sovereignty, presents interesting and challenging conceptualisations of integration theory. Weiner and Diez (2009) offer two broad theories to explain the process of integration. These will be relied on to analyse integration as a concept:

(1) Neo-functionalism and (2) Liberal Intergovernmentalism (LI).

They agree that the theories focus more on the process of integration itself and less on the political systems that result from an integration process. The result is that we find little assistance in the literature to help us understand the political and social systems that result from the process and how these systems emerge, the ways laws evolve from these institutions and the challenges resulting from the interaction between institutions and member-states. It also leaves open to challenge the assertion by commentators for example Marks et al¹² that models of EU governance leads to so

¹¹Imagine the EU: The Metaphysical Construction of a Supra-nationalist identity, p396.

¹²European Integration from the 1980s, p343.

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much of a dilution of individual state sovereignty that member-states lose their grip on power.¹³ Further, that domestic interest (and perhaps influence) is lost by this method of representation because collective decision making is effected through supranational institutions.

This assertion can be refuted (at least partially) by the evidence because if it was accurate, then the lack of harmonisation challenges that arise from the existence of directives (as well as regulations) in the EU would not exist. They do and states are left with scope to impinge on free trade and in the case of data protection, the movement of data across the EU. This is not to deny the dilution of the sovereignty argument in its entirety but dilution is a matter of degree. Also, collective EU decision making by non-elected institutions is not an absolute concept because there is still room for national interpretation and application of EU legislation as is evident in the data protection regime. As will be seen later, even with the GDPR, the EU was unable (or reluctant) to impose a completely harmonised framework and it allowed states to derogate from a number of provisions in the regulation.

1.1.1.1 *Neo-Functionalism*

This theory of integration was espoused by theorists mainly Ernst Haas and Leon Lindberg, helped along the way by the development of certain strands of integration in Europe for example the cooperation in the areas of the customs union and the common agricultural policy. Niemann and Schmitter¹⁴ identify its core concepts which include the amalgamation of federalists' ideology and functionalists' principles. The confusion generated by this type of amalgamation of ideas becomes clearer when one tries to reconcile the views of contributors to the theory. Niemann and Schmitter¹⁵ say that it can mean different things to different people mainly because of the reformations that the theory has been through. But these two of its leading proponents adopted different views even though they both

¹³This is also linked to claim that transferring power to the EU, is an attack on the democratic authority of the elected governments in member states. If anything it is the state that decides whether to transfer power and by how much. Ultimately both sides of the UK Brexit debate agree that the vote in the UK represents a state making decisions through the democratic process. EU integration does not equal an absence of democracy.

¹⁴in Weiner and Diez, p47.

¹⁵ibid.

accept that the focus should be on the process rather than the outcome; they rely on Lindberg who saw integration not as an endpoint but one in which the boundaries are in a state of flux.¹⁶ Therefore, it cannot be that we should focus only on the process. Political actors according to Lindberg are expected to constantly shift their expectations and political inclinations when it matters either to the centre or to the nation-states that make up the integrated whole.

Indeed, one of the assumptions of neo-functionalism is that practitioners will change their expectations because motives will change. The theory accepts that this is permissible and as Hass (1958) observed, neo-functionalism regarded itself as some sort of grand theory that would apply whenever it felt it needed to. It permits actors to be able to change focus and interact domestically as well as multi-nationally. Whereas functionalism denies the Hobbesian model of anarchy and conflict, insisting that for institutions like the EU and in international relations generally, states are able to organise themselves and collaborate internally, neo-functionalism insists that integration is realisable at regional level.

Again, the focus on the process of engagement does not provide an explanation of outcomes; why do states interact and produce outcomes, directives, legislation that focuses on the individual rather than the collective will of the member-states? As Howell¹⁷ posits, “*functionalism does not pursue some form of end result in the context of a political community*” and states will shift their focus and approach and they have no idea what the outcome of the integration process should be because the possibilities are infinite.¹⁸

This approach of a shift in focus as and when, was adopted by Corbey (1995). His explanation that the mutual interaction of state, the EU and interest groups which leads to uploading and cross-loading seems to argue that no group will be particularly dominant. Indeed Sandholtz’s (1994) point is precisely that: any of these groups is able to and has influenced

¹⁶Lindberg is suggesting that the authority of the state does not end within its physical boundaries. This could be argued to mean that by devolving authority to the EU, the state is still in control of the legislative process. But this extension can also create a problem because it means that it can then be argued that traditional integration, a transfer of authority has not really occurred.

¹⁷Europeanization, European Integration and Financial Services, p35.

¹⁸Popper (1994) argues that another reason why states may not be focusing on the outcome of the integration process is because they are not concerned with outcomes. In integration the state is responding to each activity or endeavour on a case by case basis and not in the context of the overall objective.

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the direction of the EU at different times. This view modifies Schmitter's¹⁹ traditional neo-functional expression that integration requires an exclusive transfer of expectations from state to supra-national institution. The original European integration project does not line up with this traditional neo-functionalism which was also espoused by Hasse (1988) hence its rejection by others like Mutimer (1989) and Pedersen (1992).

More recent expressions of neo-functional theory therefore appear to accommodate the expression of both state and supra-national intent and desire. This expression provides a better explanation for an EU that will prefer maximum harmonisation²⁰ in some matters for example the²¹:

- Consumer Credit Directive (2008/48/EC)
- Payment Services Directive (2007/64/EC) and
- Payment Services Directive 2 (2015/2366/EU) *due in force in Jan 2018*.

And minimum harmonisation in others where member states can interpret and formulate the legislation as they deem fit thereby creating a less integrated approach for example²²:

- The Bank Recovery and Resolution Directive (2014/59/EU)
- Trade Secrets Directive (2016/943/EU)

In this regard neo-functionalism is at odds with traditional variants of integration and those theorists who argue that interest aggregation at the centre will always prevail. Traditional intergovernmentalists also take the same view. They insist that a predefined model will always prevail and any form of integration that does not accord with this prescription will fail.

¹⁹A Revised Theory of Regional Integration, p238.

²⁰Maximum harmonisation is the principle where national law is not allowed to exceed the terms of the EU directive.

²¹There is no therefore no predefined or predetermined expression of the response of the state. Corbey (1995) and Sandholtz (1994) are suggesting that integration will produce a certain kind of behaviour; that we should expect the state to behave contextually. Its response will depend on the context, the circumstances or on the particular legislation. The central EU interest can be expected to dominate sometimes whilst the state interests will prevail at other times. It is impossible to always predict what the response will be.

²²Maximum and minimum harmonisation are not the only possibilities. The EU has long grappled with the challenge of trying to unify divergent view-points amongst member states. For example it allowed maximum harmonisation coupled with mutual recognition—two separate concepts in the Consumer Credit Directive because it could not reconcile the positions of the Parliament and those of member-states (Directive 2008/48/EC).

Liberal intergovernmentalists allow for a modification of the predefined model and for the purposes of this book this school of thought provides a more applicable approach.

It is necessary to examine some of LI's claims.

1.1.1.2 *Liberal-Intergovernmentalism (LI)*

As a theory which prides itself on its ability to understand and explain interstate engagement and cooperation, LI asserts its micro-foundational assumptions. It specifies what motivates relevant actors (in this context these will include nation states, their leaders and social actors) whilst at the same time helping to predict behaviour. It ascribes to itself an ability to be able to determine and aggregate from their interactions, how actors will make determinations which it also claims can be tested empirically.²³

Interestingly LI comes to the conclusion that states in their sovereignty and self-centeredness will be driven by self-interests but at the same time argues that these states even though they are central to the European integration process, remain committed to their own national (as opposed to supranational) interests; they are incapable of pursuing the collective will.²⁴ Even when they come together it is only to protect their national interests. In the expression of collective intent (which LI does not argue is impossible), states will consider their own preferences and any outcome will accommodate those preferences even when they appear irreconcilable.²⁵ So just like the recent expressions of neo-functionalism, one finds the expression of both national and supra-national intent in LI. In modern integration theory, it is difficult to argue that integration will always see states accede to a transfer of power without qualifying how and why. Integration does not necessarily see the state give up its sovereignty nor will it always subjugate its interests for those of the centre.

²³Moravcsik et al (in Weiner & Diez, p68).

²⁴Howell, 2004, p34.

²⁵Therefore in the context of data protection for example, states will accede to an EU position only when the subjective state interest is reflected in that position however inconsistent the outcome may be. This does not mean that all outcomes will be inconsistent. The state will only assert a state interest where such interest exists. In matters of collective defence for example there is less conflict because of the advantages of a collective response to acts of aggression.