

EPFSF Briefing “Financial Supervisory Architecture”

Background

The financial crisis revived a long standing need to review the present EU arrangements for systemic risk management and regulatory and supervisory cooperation, to ensure that they were adequate to address global and European market integration. The severity with which the crisis hit Europe created a political momentum to design a stronger coordinated supervisory framework in Europe.

In parallel, the G-20 Washington Summit in November 2008 and London Summit in April 2009 prompted a review of global arrangements, with the expansion and strengthening of the Financial Stability Board, and the formalisation of colleges of supervisors to provide a framework of worldwide cooperation and coordination.

Commission President Barroso, in October 2008, mandated an expert group chaired by Jacques de Larosière to make recommendations on the future of European financial services regulation and supervision. The February 2009 “de Larosière Report”¹, amongst other recommendations for reform, proposed the establishment of a European Systemic Risk Council, and replacement of the current Committees of European Supervisors (“Lamfalussy Committees”)² with a European System of Financial Supervision, consisting of three new European Supervisory Authorities for banking, insurance and occupational pensions, and securities, operating in a network with national competent authorities.

The Commission endorsed the Report and proposed in its May 2009 Communication³ a new European Systemic Risk Board (ESRB)⁴ and a new European System of Financial Supervisors (ESFS) that are broadly in line with the Report’s recommendations, although the Commission proposed an accelerated implementation timetable.

The June 2009 European Council unanimously approved the project after the reservations of some Member States had been resolved. A compromise notably specified that “decisions taken by the European Supervisory Authorities should not impinge in any way on the fiscal responsibility of Member States”.

Objectives

While the current three Lamfalussy Committees are charged with advising the Commission on financial services legislation, improving supervisory cooperation and promoting convergent implementation of legislation in the Member States, they operate by consensus and do not have any legal powers under EU law.

In the envisaged supervisory architecture, the current three Committees would therefore be turned into European Supervisory Authorities with a European mandate and legally binding powers in some areas to fulfill their functions. They would notably contribute to enhance cooperation and convergence between national supervisors and help to reduce the inconsistencies that can arise from the large number of national options and discretions in EU banking legislation”. A key feature revealed by the crisis is the depth of financial markets’ interconnection and their exposure to

¹ http://ec.europa.eu/internal_market/finances/committees/index_en.htm#delarosierereport

² The Committee of European Supervisors (CEBS); the Committee of European Securities Regulators (CESR); the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

³ Communication on Financial Supervision in Europe:

http://ec.europa.eu/internal_market/finances/committees/index_en.htm#communication

⁴ The term “Board”, replacing the original term “Council”, was suggested by the June 2009 ECOFIN Council

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complex and cross-sectoral systemic risks. Therefore, a fundamental objective of the EU and global reforms is to give a “macro” dimension to financial stability coordination and prudential supervision (i.e. to consider and address risks to the stability of the financial system as a whole) – at global as well as EU level - but importantly also to link – both structurally and institutionally - this “macro” level to the “micro” level: the supervision of individual financial institutions.

In this respect, it is important to acknowledge that different financial sectors have different business models. Accordingly, the extent and the way in which the respective financial sectors have contributed and been exposed to the financial crisis have varied depending on the specificities of their business models. The same can be said about their relative systemic importance to the financial system as a whole. These issues need to be considered in the supervisory reform while assuring a level playing field between providers of the same service.

Financial Supervisory Architecture

The Commission brought forward on 23rd September legislative proposals for Regulations establishing:

- A European Systemic Risk Board (ESRB) for macro financial stability oversight which would collect and analyse information from national supervisory authorities and the three European Supervisory Authorities, and provide early warnings as well as recommendations for remedial action where relevant.

Members of the ESRB would include the ECB General Council (i.e. the President and vice-President of the ECB and the governors of all Member States’ central banks), the Chairs of the three European Supervisory Authorities, and a representative of the European Commission. Non-voting members would be the Chair of the Economic and Finance Committee (EFC) and one representative per Member State of the national supervisory authorities. The ECB General Council would elect the Chair and vice-Chair of the ESRB from amongst its members. It will be important to ensure that the ESRB has adequate representation from all three financial services sectors.

- A European System of Financial Supervisors (ESFS) composed of the three new European Supervisory Authorities⁵ covering banking, insurance and occupational pensions, and securities, operating in a network with the national supervisory authorities, which would remain solely and legally responsible for the supervision of financial institutions.

The Authorities would take over the tasks and duties of the three Lamfalussy Committees. In addition, they would have binding powers in specific areas to be determined in the respective sectoral directives⁶, including the power to develop binding technical standards⁷ as well as to settle disagreements between national supervisors. For the first time, a formal pan-EU supervisory role would be granted to the Authority over credit rating agencies. The new Authorities would work towards a single set of harmonised rules.

The devil is in the detail

While there is broad consensus on the overall shape of the forthcoming reform, much debate is expected on the detail. The detail, for example in respect of the scope of technical standards and of the binding powers of the EU Authorities, will be in the amendments to the respective sectoral Directives (expected to be published on 28th October) as well as in the above-mentioned 23rd September proposals for Regulations setting up the new Authorities.

⁵ Plus a joint Committee of European Supervisory Authorities on financial conglomerates

⁶ CRD; MiFID; Prospectus; MAD; Transparency; UCITS; Financial Conglomerates; Solvency II; IORP; Insurance mediation; CRA; AML

⁷ These standards will have to be endorsed by the Commission; their scope will be specified in the above-mentioned Community legislation.

Furthermore, continuing effort will be needed, since supervisory and fiscal responsibilities remain national prerogatives, to develop an efficient and effective European supervisory culture and framework in a way that aligns with firms' management of their cross-border operations, and with the objective of the single market.

Financial stability and crisis management

The crisis has demonstrated that safeguarding financial stability requires improved coordination between all public authorities: supervisors, central banks and finance ministries.

New, more formal arrangements for supervisory cooperation, including coordination through colleges, streamlined interpretation of harmonised rules and convergence of supervisory practices, are designed to overcome obstacles arising from national differences, strengthen crisis prevention, and contribute to trust building and financial stability. It has nevertheless been argued that as crisis management and resolution involve national funding and applying national insolvency law, the scope for and effectiveness of the adoption of prompt and coordinated cross-border responses to crises that are playing out across the globe is limited.

To support cross-border financial stability, the Commission is expected to propose soon improvements to the EU early intervention and crisis management frameworks. It remains to be seen whether and how it is possible to make further progress on EU burden sharing arrangements.

Briefing notes are prepared by the Financial Industry Committee to the European Parliamentary Financial Services Forum. For further information on the subjects raised in the briefs please contact the Chairman, Members or Secretariat of the Financial Industry Committee.

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