Financial supervision future model

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European Parliament

We’ve told you before…………..

Some history from the EU/EP archives

- 1999 FSAP fast track legislation
- 2001 Lamfalussy Committee of Wise Men
- 2002 Van den Burg EP report Prudential Supervision
- 2005 official structure for 3L3 (CESR, CEBS, CEIOPS)
- 2005 Van den Burg EP report FSAP
- 2006 Muscat EP report consolidation financial sector
- 2007 Van den Burg EP report FSAP
- 2008 Van den Burg/Daianu Lamfalussy follow up
- February 2009 De Larosiere report
- October 2009 Commission proposals

EP report vdB 2002

- ***"notes that the current stage is a <u>transition in a trend</u> which will ultimately lead to the creation of one or several European integrated supervisors"(art 47 resolution)***
- ***"urges (…) to organise a comprehensive public debate with all the relevant players about <u>European integrated supervision</u>, focusing on examining the feasibility of European supervision of large financial institutions with cross border and cross sector operations"(art 49)***
- ***"would support the establishment of an <u>EU-wide forum</u> of financial authorities at the highest level with the participation of the ESCB and ECB…"(art 45)***

NB in explanatory statement:

"…..your rapporteur bets that in a decade a European supervisor will emerge…."

EP report vdB 2005

- ***Welcomes Himalaya report CESR: need for <u>convergence supervisory powers, responsibilities and practices</u> (art 12 resolution)***
- ***"Urges the European institutions to encourage convergence by continuously assessing whether the level of cooperation between supervisory authorities is sufficient, or whether, in due course, consideration may have to be given to developing some form of integrated supervision at European level, including among the options the possibility of a <u>two-tier system of supervision at European level for large cross border players, without distorting the level playing field for local players"</u> (art 17 resolution)***
- ***"…………art 18 of the plenary resolution about the concept of <u>"lead " or "consolidating" supervisor</u>, and "guidelines or (…) rules for <u>transfer of decision-making powers between supervisors, the resolution of conflicts and for last-resort decision-taking</u>", and the possibility of a <u>mediation role for the 3L3 committees</u>***

EP report Muscat 2006(1)

- ***7. Recalls that consolidation should not be an political objective per se, but should bring clear benefits to the economy by stimulating growth, encouraging innovation, ensuring competition, improving access to funding, allowing financial institutions to exploit synergies and cost efficiencies, and giving consumers a greater choice and better quality, while ensuring an adequate level of consumer protection;***
- ***8. Asks for attention to be focused on the effects of consolidation in the financial sector on employment, by restructuring ownership and activities, and by outsourcing in particular; urges the sector to provide for accompanying measures that lead to retraining and qualifying financial institutions' staff to fit in with the Lisbon Strategy goals of becoming a more knowledge-intensive economy;***
- ***9. Believes that diversity of financial institutions, which better reflects the variety of financing needs of corporate entities, SMEs and consumers, should be preserved and that, therefore, EC legislation should not favour any single type of business model or corporate structure or any single type of product over another;***

EP report Muscat 2006(2)

- ***34. Notes that in highly integrated financial markets, a crisis spilling over national jurisdictions cannot be tackled individually by national authorities; in this respect, considers that the <u>current networks</u> of national supervisors, the supervisory arrangements, and the non-legally binding memoranda of understanding <u>may not be sufficient to face a major crisis caused by a failure of markets or important cross-border financial groups</u>; considers that cooperation and mutual trust between supervisory authorities in a crisis event is crucial and urges the Commission and responsible national authorities to develop jointly appropriate proposals for effective crisis management for the further consideration of the Parliament;***
- ***35. Considers that the <u>EU's authority in international negotiations</u>, particularly as regards bank supervision, would be reinforced by the clarification of its internal functioning;***
- ***36. Notes that the question of the <u>lender of last resort</u> must be solved before it is possible to focus any further discussions about EU financial supervision; in this respect, stresses that a clear decision on responsibilities is necessary;***

EP report Muscat 2006(3)

- ***Believes that it is high time that the EU institutions, and particularly the Parliament, opened a debate on the structure of supervision of EU financial markets; for this reason, calls for the setting up of a <u>committee of "wise men"</u> to study - and report back before the end of 2006 - the implications of the consolidation of markets and financial institutions, prudential supervision, financial stability, and crisis management; in this regard, asks the committee to propose concrete ideas regarding the simplification of multiple reporting requirements and the improvement of the current structures, and, ultimately to reflect on the needs and structures of European financial supervisors;***

EP report vdB 2007(1)

- ***"Urges the three Level 3 committees (…) to ensure that all financial institutions are <u>equally supervised on a functional basis</u> in all Member States (art 55)***
- ***"suggests a review of whether it may be helpful if Level 3 committees could operate increasingly on the basis of decision-making by some form of <u>qualified majority voting</u> where its principles still have to be defined; (art 56)***
- ***"recommends that Lamfalussy Level 2 and Level 3 committees' respective powers and mandates be defined more precisely in order to reflect the need to progress towards a greater convergence of their practices and to let them take, within the remit of their activities, <u>binding decisions</u> vis à vis their members; (art 56)***

EP report vdB 2007(2)

- ***Emphasises the importance of an integrated European system of cooperation between national and sectoral supervisors, capable of securing the efficient supervision of both big financial players and local entities rooted in national traditions; (art 57)***
- ***Understands why Member States wish to allow new arrangements time to be implemented and tested before considering any further moves towards convergence; points out that, if progress is not made in this direction, pressure for consideration of a <u>centralised supervisory arrangement</u> may be increased; therefore advocates that, in these circumstances, <u>closer convergence in supervision and cooperation between home and host supervisors</u> within the existing structures becomes a matter of particular importance; (art 59)***

EP report vdB 2007(3)

- ***Notes that, for effective oversight of the systemic and prudential risks of the top market players, the present system of cooperation may need to be strengthened on the basis of the system of cooperation that exists among supervisors, and encourages greater coordination, in particular with respect to prudential risk supervision of multi-jurisdictional and cross-sectoral entities and financial conglomerates; encourages agreements and codes of conduct between Member States and central banks on the financial backing of this system of prudential supervision, with respect to bail-out and lender-of-last-resort obligations where several Member States and more supervisors are involved; notes that, to judge whether the present system provides for a real oversight of the systemic and prudential risks of the top players in the market, it is necessary to give the relatively new Level 2 and Level 3 arrangements time to bed down and, at the same time, to look into the desirability and feasibility of EU-level execution of prudential supervision where needed in the future; (art 58)***

EP report vdB 2007(4)

- ***is positive about colleges of supervisors dealing with multi-jurisdictional financial conglomerates; calls on the colleges of supervisors to foster a common European supervisory culture and to determine exactly where the limits of such voluntary cooperation lie when real crisis situations appear; notes, however, that these colleges lack the national mandates to transfer competences, to accept majority decisions, or simply to put sufficient resources and expertise into the colleges' work; points out, therefore, the necessity of defining a framework and national mandates for cooperation and expects the colleges of supervisors and the operational networking project to provide necessary practical solutions (memoranda of understanding) for the supervision of cross-border groups within a short time frame; (art 60)***

EP report vdB 2007(5)

- ***Emphasises that <u>home-host supervisory cooperation</u> is the most significant building- block in the set-up of the single financial market; notes in particular that, in the field of the supervisory approval process for mergers and acquisitions, there is much to do to facilitate the creation of efficiently functioning financial conglomerates with wider economies of scale; maintains that the banking market landscape of the country where the acquired financial entity is domiciled must be taken into due consideration; (art 61)***

EP report vdB 2007(6)

- ***considers that a <u>more precise allocation of roles</u> is desirable between the Council, the Commission, and the Level 3 committees; considers also that, for strong supervision, (particularly where there is a clear link to competition issues) <u>a high level of independence and neutrality is required</u>, which cannot be well combined with an overly political profile; (art 62)***
- ***Welcomes the decision of the Economic and Financial Affairs Council to set up a Financial Services Committee subgroup on long-term supervisory issues, which is due to report in October 2007; expects that group to give a fair assessment of the present situation which, together with the final report of the IIMG that is also expected in autumn 2007, the report of Parliament and the expected follow-up report of the Commission, may create <u>momentum</u> for an assessment of the remaining challenges to the integration and effectiveness of the financial regulation and supervision architecture, and provide commitment for possible recommendations for <u>further steps</u>; (art 63)***
- ***Invites the IIMG to take a broad perspective on the challenges and opportunities facing the European system of supervision and to contribute to a <u>further forward-looking debate</u> in its final conclusions (art 65)***

EP report vdB/D 2008 (1)

supervision of large cross border financial groups:

- Requirement of mandatory colleges of supervisors for the largest EU financial groups
- Full process leadership of consolidating supervisor
- Ensure collection, exchange and access of/to information amongst college supervisors
- QMV voting

EP report vdB/D 2008 (2)

Level 3 committees:

- Legal status
- Adaptation national mandates
- QMV voting
- Conflict mediation procedures for colleges by L3 committees
- Binding conflict resolution by 3L3 chairs plus independent chair & vice chair nominated by Commission and approved by EP for 5 year term

EP report vdB/D 2008 (3)

Financial stability arrangements:

- 3L3 together with ESCB/ECB
- Early warning & rapid reaction
- Central supervisory data collection, exchange and analysis & procedures for confidential data
- External international representation

De Larosiere report(1)

Sense of urgency:

- *“World faces very serious economic and financial crisis”*
- *“EU is suffering”*
- *“Huge government spending to stabilize the banking system”*
- *“Financial regulation and supervision too weak or wrong incentives”*
- *“Repair is necessary and urgent”*
- *“Action is required at all levels”*

Recommendations:

- > new regulatory agenda
- > stronger coordinated supervision micro & macro
- > effective crisis management procedures

Message:

- “chacun pour soi” or enhanced pragmatic European cooperation
- Step by step, but start immediately

Turner review 2009

Similar analysis, similar dilemma:

- More Europe or more national powers?
- Internal market European passports with home country supervision vs national deposit insurance and crisis management

Similar……

- New independent EU institutional structure to replace 3L3, with regulatory powers as a standard setter and supervisor of the supervisors

….but slightly different conclusion:

- Primary microprudential supervision of individual institutions remains national (with extra host country supervisory powers over liquidity and capital requirements locally)

USA reforms

Geithner/Summers:

- Financial Services Oversight Council
- National (=federal) Bank Supervisor
- Office of National Insurance in the Treasury
- Consumer Financial Protection Agency
- SEC remains investor protection agency
- > still central role Treasury
- > every interest group its own agency
- > more cooperation

Obama/Volcker:

- Cap maximum size/market share
- Separate proprietary trading from (govt protected) banking
- > More fundamental reform
- > more focus on anti-trust and competition instruments

Regulatory capture (1)

Both in the US and the EU there is a (too) close relationship between supervisors, supervised and governments:

- MS have major national interests in the finance industry (London City, Paris Europlace, Finanzplatz Frankfurt, Holland Financial center, etc….)
- Professionals move positions in their personal careers between private business, ministries, regulatory and supervisory agencies/central banks and service providers for the finance sector (credit rating agencies, audit firms, consultancies)

<u>Sensitive issues:</u>

- **Independence**: EU agency legal status & independent chairs
- **Mandatory sharing of** (confidential and competition sensitive) **information**
- **Binding mediation/conflict resolution** for colleges of supervisors and 3L3

Regulatory capture(2)

Broader approach supervision than only macro-micro prudential:

- > Stronger role for competition and investor protection authorities and instruments (enquiries, insider dealing, frontrunning, shortselling, porous chinese walls, anti trust, forced split offs in case of market dominance)
- > Interdisciplinary teams DG COMP together with prudential supervisors (EP resolution European Summit october 2008)
- > Not only state aid focus, but restructuring, level playing field, back to basics: credit provision for (new) SME's, effective payment systems, retail products, liquidity, long term investments in real economy > EU restructuring plan like ECSC
- > Anti trust, market abuse, conflicts of interest should be focus for G20, FSB as well!

Regulatory capture(3)

SELL SIDE >< BUY SIDE:

- Disproportionately dominant sell side lobby and policy input in EU financial markets regulation and supervision
- Alter EU: 19 FSAP expert groups count 229 corporate sell side advisors and only a handful of consumers'and trade union representatives
- Buy side is heavily underrepresented
- end users financial services: private consumers, investors, SME entrepreneurs) are almost absent
- Long term oriented institutional investors (pension funds, sovereign funds, insurance companies, investment funds) have a lack of interest and input in dossiers that do not directly concern their own sector and (sell side) business
- Background regulators/supervisors predominantly sell side

Recommendation(1)

BACK TO BASICS:

- financial services should be again ***servant*** instead of ***master***, serving the real economy and making an optimal link between supply and demand
- Approach regulation and supervision broader than only focused on access to markets for service providers (EU passport for the internal market)
- Treat financial services as services of general interest: outline and ensure the public service obligations and conditions for accessibility and affordability, quality, risk management, etc
- Prevent moral hazard and regulatory arbitrage

Recommendation(2)

SELL SIDE >< BUY SIDE:

- Reïnforce input and expertise buy side by **financing** from the EU budget **expertise** on financial markets regulation & supervision
- ***EP FSAP report 2007 pt 38: "Welcomes the establishment of the Financial Services Consumer Group and the attempts to involve user representatives in expert groups and consultations; notes, nevertheless, that the voice of consumers and end users such as small and medium-sized enterprises (SMEs) lags far behind that of the financial industry; <u>recommends the creation of a European budget line to finance financial market expertise in consumer and SME organisations in order to feed into the FSAP consultation processes;</u>***
- Qualify the composition of stakeholder advisory committees in the new supervisory agencies proposal: at least half of the members should be buyside!
- Idem for Commission and supervisors expert groups
- Organise and facilitate consultations of consumers, sme's and end-users
- Stimulate long term investors' attitude via public-private cooperation (EIB), and in company law & corporate governance

Recommendation(3)

INDEPENDENCE AND AUTHORITY AT EU LEVEL:

- Strengthen the independence of the regulatory and supervisory actors
  * EU vs national
  * cross sector vs sectoral
  * enhance status and remuneration supervisor vs private sector jobs
- Be aware of, avoid and actively counter regulatory capture
- Focus on the top of the market: the +/- 40 large cross border financial conglomerates – if necessary in a two tier system
- Guarantee level playing field through common rule books for the business activities of all (large & small, cross-border & local) players
- Execute strong anti-trust and anti-market abuse/conflict of interests supervision
- Give EU independent supervisory system a strong role in the global supervisory architecture (decrease government and central banks dominance)

Recommendation(4)

FURTHER STEPS FOR EP & COMMISSION:

- Organize a joint committee of National Parliaments and European Parliament with aggregated enquiry powers to assess what exactly went wrong between supervisors, treasuries and central banks, and to draw lessons for the future architecture
- Make DG COMP together with the other relevant DG’s do an in depth inquiry for the financial sector in the EU, leading to conclusions for a balanced restructuration
- Adopt the Commission proposal for the European Financial Supervisory agencies and the European Systemic Risk Board asap with the appropiate adaptations to facilitate the 3L3 work anb the cooperation between national supervisors for the short term
- Create a new Wise Persons Group to elaborate the further steps that the De Larosiere Group indicated already, focused on the (two tier) direct execution of supervision of the +/- 40 large players
- Create another high level group to elaborate a better structure for financial consumer and investor protection and consultation in the EU architecture