EU Communication

EUROPEAN FINANCIAL SUPERVISION

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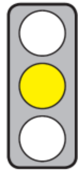
Centrum für Europäische Politik

MAIN ISSUES

Objective of the Communication: The Commission wishes to replace the existing system of national supervisors with a European financial supervision composed of two new pillars.

Parties Affected: All financial institutes in the EU and national supervisory authorities.



Pros: (1) The proposed supervisory architecture, including the establishment of new authorities at EU level, is appropriate in view of the risks emerging from integrated financial markets in the EU.
(2) The harmonisation of supervisory rules can reduce the costs of supervision over cross-borderly active financial institutes.

Cons: (1) A centralisation of the supervision of rating agencies and clearing houses is not necessary. The colleges of supervisors of national supervisory authorities can also fulfil this task.
(2) In view of prevailing ECJ case law, the independent decision-making powers of new EU supervisory authorities are problematic.

CONTENT

Title

Communication COM(2009) 252 from the Commission of 27. May 2009: **European financial supervision**

Brief Summary

- **Background**
  – The Commission is convinced that the financial crisis has exposed "important failures" in financial supervision in the EU. It is of the opinion that nationally-based supervisory models have lagged behind the reality of financial institutions operating across borders. Furthermore, the crisis has exposed "serious failings in the cooperation, coordination, consistency and trust" between national supervisors. (p. 2)
  – Therefore, the Commission proposes establishing two new pillars in financial supervision in the EU (p. 3):
    - a European System of Financial Supervisors (ESFS) to safeguard the improved supervision of single financial insitutions ("micro-prudential supervision") and
    - a European Systemic Risk Council (ESRC) to ensure the improved handling of risks for the stability within the whole financial system ("macro-prudential supervision").
- **European System of Financial Supervisors (ESFS)**
  – The European System of Financial Supervisors (ESFS) is to be a "network" of national and European supervisory authorities built on "shared and mutually reinforcing responsibilities" (p. 3 and 9).
  – As part of ESFS, a European Banking Authority (EBA), a European Insurance and Occupational Pensions Authority (EIOPA) and a European Securities Authority (ESA) are to be established.
  – These new EU authorities are to constitute bodies with an independent legal personality and each to have their own budget. The presidents of all three authorities would each be elected for a term of five years. Their appointment is to be subject to the European Parliament's approval.
  – In order to be able to react adequately to cross-sector risks, an "overarching steering committee" consisting of representatives of the newly established EU authorities and of the Commission is to support the ESFS.
- **Tasks of the national financial supervisory authorities in ESFS**
  – The national supervisory authorities have the following tasks in ESFS:
    - to "safeguard financial soundness at the level of individual financial institutions" and "protect" consumers of financial services (p. 3) and
    - to monitor cross-border institutes in "colleges of supervisors" (p.9) which are headed by the authority of the Member State where the institute concerned has its head office; representatives of the new EU authorities participate in the meetings of the colleges of supervisors as observers.
  – As the supervision of individual financial institutions falls under the competence of Member States, it is clear to the Commission that the financial means for the rescuing of individual institutions must be raised by Member States, i.e. national tax payers. (p. 9)
- **Tasks of the new EU authorities in ESFS**
  The Commission proposes to assign the following tasks to the new EU authorities:
  – harmonisation of the supervision rules by developing binding technical standards (e.g. for the validation of internal models used by banks to measure risks) and by developing binding guidelines (in particular for the licensing and supervision of financial institutions);
  – ensuring the consistent application of EU rules, in particular through EU authorities
    - settling disputes between national supervisors in a binding manner,

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  - imposing fixed periods of time for taking certain recommended action on national supervisory authorities which manifestly infringe Community legislation and, on the occasion that the infringement pertains, inform the Commission, which then should take a decision in the matter;
- development of a common supervisory culture, e.g. by common training programmes;
- exclusive responsibility for the supervision of "certain entities with pan-European reach" such as rating agencies or clearing houses, including the licensing and the supervision of these institutions;
- coordination of national supervisory authorities in crisis situations, including the adoption of "emergency decisions" (e.g. on short-selling);
- establishment of a central European database for information which national supervisors receive while supervising financial institutions;
- conclusion of technical arrangements with international organisations (e.g. with the IMF) and with administrations of third countries (e.g. with the US-American Central Bank Supervision).

► **Decisions in the European System of Financial Supervisors (ESFS)**
- ESFS decisions are taken jointly by the chairman of each competent EU authority (EBA, EIOPA or ESA) and the chairmen of the national supervisory authorities.
- Decisions on "technical rules" require a qualified majority based on the same vote weighting as in the Council. For decisions regarding "other functions", such as the application of existing laws, the Commission proposes a simple majority, unless "separate arrangements" have been made (p. 13).

► **European Systemic Risk Council (ESRC)**
- The main task of the European Systemic Risk Council (ESCR) is to monitor, as an independent body, any risks to the stability of the financial market in the context of macro-economic developments and trends in the financial sector.
- The ESRC is to have meetings at least four times a year and is to provide an "early" warning of system-wide risks. "Where necessary" the ESRC issues recommendations to contain risks; the adoption of these recommendations is subject to a simple majority. The ESRC may address them to individual Member States. Member States which do not follow such recommendations must justify why ("comply or explain" mechanism). (p. 5).
- The following institutions must be represented in the ESRC, having one votes each:
  - the European Central Bank represented by its president or vice president, if the president is appointed chairman of the ESRC,
  - 27 national central banks,
  - the three European financial supervisors EBA, EIOPA and ESA each represented by their chairmen,
  - the European Commission.
- The following persons may participate and speak in ERSC, though they do not have any rights to vote:
  - representatives of national supervisory authorities accompanying the president of the national central bank in meetings,
  - the chairman of the Economic and Financial Committee, representing the national Ministers of Finance in ESRC meetings.

Changes Compared to the Status Quo

► Until now there has been not a EU authority for financial supervision but three committees without legal personality composed of representatives from national supervisors (CEBS for banking supervision, CEIOPS for insurance supervision and CESR for the supervision of securities). The Commission extended their powers through several decisions on 23. January 2009 (cp. CEP Policy Brief).
► CEBS, CEIOPS and CESR advise the Commission in drawing up detailed implementation provisions and aim at harmonised supervisory practices in the EU, but do not have any decision-making powers. The new EU agencies, however, are to be entitled to settle disputes between national authorities, adopt binding rules and guidelines and take emergency decisions for the coordination of national authorities.
► To date there is no central supervision on rating agencies and clearing houses at EU-level, which the Commission intends to assign to the new EU authorities. Neither does a European body exist that assesses risks for the financial stability as has now been proposed for the ESRC.

Statement on Subsidiarity

The Commission does not deliver any formal statement on subsidiarity. However, it does highlight the fact that the financial supervision in the EU, which hitherto was shaped in a national manner, proved incapable of dealing with the financial crisis adequately.

Political Background

The report presented by a high level group headed by the former IMF president, Mr. Jacques de Larosière on 25. February 2009, contains recommendations for a European financial supervision. In particular, the report favours a strengthened cooperation between and a better coordination of national supervisors. Hence, by 2012 new European supervisory authorities and a body for monitoring systemic risk are to be established.

In its Communication to the spring meeting of the European Council in March 2009 [COM(2009) 144], the Commission welcomed that report and announced legislative measures. The current Communication substantiates these measures and sets out the basic architecture for a European financial supervision. Subsequently, the Commission intends to propose legislative measures. Several Member States (Great Britain in particular) have criticised the Commission's plans as being too far-reaching. Other Member States (e.g. France), in turn, call for an extended centralisation of supervision at EU level.

The Council first discussed the Commission's plans on 9. June 2009 and clarified that decisions taken by the new EU authorities may not affect the budgets of the Member States. Due to possible financial burdens the decision-making power for settling disputes, for monitoring rating agencies and clearing houses as well as the power to take emergency decisions, if necessary, is particularly controversial.

During the European Council on 18. and 19. June 2009, the Heads of State and Governments shared these concerns and stressed again that the "decisions of the European supervisory authorities must not affect the budgetary competence of Member States, at all". However, there is no consensus regarding the question of whether or not the proposed changes to the financial supervision can be based on Art. 95 TEC. Great Britain has already expressed doubts.

Options for Influencing the Political Process

Leading Directorate General:	DG Internal Market
Consultation procedure:	The Commission invites representatives of all interested groups to give Statements by 15. July 2009.

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

Since the beginning of the financial crisis the Commission has made a series of proposals for an improved financial market supervision which, on the whole, are very target-oriented (cp. CEP Policy Brief).

In fact, financial supervision in the EU suffers from outdated structures, both at the micro and the macro level. The existing **financial supervision in the EU, which is based on national structures**, **fails to cope with the current risks** that the close international interconnections of financial markets bring about. **It is to be expressly welcomed that** now **the Commission is** increasingly empowering both supervisory levels and intends to tie them closer together by **proposing the establishment of a European System of Financial Supervisors (ESFS) and a European Systemic Risk Council (ESRC)**.

The ESRC should cooperate as closely as possible with similar authorities at international level. Only then can risks for the financial system, which became globally tied long ago, be identified. Whether the non-binding recommendations of the Council will be complied with depends on their credibility which, in turn is affected by the Council's constellation.

The Commission's **proposal for the formation of the ESCR is acceptable as a compromise solution**. The key role of the central banks in this body is appropriate. In view of their activities in the money market and the fact that maintaining financial stability is already part of their mandate in many Member States, they are well acquainted with monitoring capital markets. **The key role of the ECB within ESRC is a diplomatic challenge**, since the ECB only has monetary policy competences for Euro-States, but now is to receive voting rights in assessing also the situation of financial markets of Non-Euro-States as well, through its chair in the ERSC. It is questionable to what extent the ECB will be willing to be unsparing in its assessment if, for instance, the Bank of England is affected. There is no objective reason why the Commission should be represented in the ESRC.

The recommendations for the ESFS are not altogether convincing. On the one hand, much speaks for a stronger coordination of the content of the supervision of financial institutions operating across borders. **It is to be welcomed that for the time being the Commission** – even though the exact modalities of voting in the ESFS are not yet determined – **does not plan to establish a broadly centralised supervision at EU level**. For due to the massive differences in national legislation it would hardly be feasible in the medium term. **The new EU authorities EBA, EIOPA and ESA** may be getting individual decision-making powers, but in the end they remain dependent on the cooperation with national supervisory authorities, which overall actually creates an elaborate federal supervisory model.

On the other hand, the new EU authorities raise follow-up questions which in the end can only be clarified politically. **The main issue is that the ensuing costs generated by decisions taken by these authorities** – e.g. the question of whether or not a bank is system-relevant and, as a result, is to be saved from insolvency– **must be borne by the Member States**. It is questionable whether all Member States will be willing to accept the divergence between decision-making competences and taking financial responsibility for the consequences.

The *exclusive* competence of EBA, EIOPA, and ESA for the monitoring of rating agencies and clearing houses may be used as a door opener for an extended **future centralisation**. This sort of supervision could equally be accomplished by the existing national colleges of supervisors.

Impact on Efficiency and Individual Freedom of Choice

Harmonised rules can reduce costs related to the supervision of financial institutions operating across borders.
The proposed competences of the new EU authorities to settle disputes between national supervisory authorities and to handle crisis situations can increase the efficiency of the financial market supervision, yet will hardly be feasible in terms of policies.

Impact on Growth and Employment

Not foreseeable.

Impact on Europe as a Business Location

In particular the work of the ESFS can improve supervision and strengthen the stability of financial markets, which is essential for the credit supply of the real economy. The attractiveness of the EU as a location for investment is thereby increased. However, due to the complex global interconnection of financial markets, the stability of the European financial market also depends on supervisory standards in other parts of the world.

Legal Assessment

Legal Competence

For the proposed amendments of financial market supervision in the EU the Commission refers to Art. 95 TEC as the legal basis and is principally right in doing so, yet there are Member States that do not share this opinion (see CEP Legal Opinion in German only). The envisaged measures serve to improve the functioning of the internal market of financial services. In particular, if national supervisory systems differ from each other they can prevent financial institutions from entering another market. To this end, the establishment of new EU financial supervisory authorities with certain decision-making powers is appropriate to improve the functioning of cross-border markets for financial products. The proposals are equally appropriate to increase the stability of the financial markets and to improve the functioning of the internal market. However, it will not be clear whether or not their concrete design adheres to the limits of Art. 95 TEC until the Commission has submitted the regulation on the establishment of new EU authorities.
The assignment of tasks for the supervision of credit and financial institutions (but not insurance companies) to the ECB follows from Art. 105 (6) TEC.

Subsidiarity

Depends on the concrete design of the announced regulations.

Proportionality

Depends on the concrete design of the announced regulations.

Compatibility with EU Law

The planned **decision-making powers of the new EU authorities are problematic in terms of the "Meroni"-decision by the ECJ** (No. 9/56). According to this decision, the balance between the institutions enshrined in the treaties excludes the establishment of any new bodies with final decision-making powers. In as far as the establishment of an EU authority is not directly provided for by the treaties, only executive powers may be assigned to them, the performance of which is fully subject to the Commission's control.

Compatibility with German Law

Depends on the concrete design of the announced regulations.

Alternative Policy Options

A cut of the powers of the new EU authorities – e.g. in the area of rating agencies and clearing houses – could dispel political doubts without lowering the quality of supervision.

Possible Future EU Action

On 30. September 2009, the Commission plans to propose three regulations establishing the new EU agencies EBA, EIOPA and ESA. The agencies are to become operative by 2010. The Commission further announced that it intends to reach "a more harmonised set of financial regulations" by "flanking measures" and "changes to the sectoral legislation"; in addition, it has announced proposals for "greater consistency in the national powers" of supervisory authorities (p. 9).

Conclusion

The new, two-pillared supervisory architecture closes the gaps in EU financial supervision, which is currently essentially national in nature. It is reasonable that financial supervision will not become excessively centralised. But even a partial centralisation raises the question of whether Member States are willing to accept decisions taken by EU authorities that might have long ranging effects on their national budgets. Besides, independent decision-making powers for EU authorities would be problematic in view of the previous case law of the ECJ.