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Eddy WYMEERSCH
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Abstract

I am very pleased to expose to you a subject that is keeping me and many other people very busy these days, which is the revision of the financial supervisory system. It is a great occasion to present, once more in Milan, the views that are being developed at the European level. I was asked to deal with the "European Supervisory System". I will only develop the micro-supervision, which is the supervision on banking, insurance, pension funds and securities markets. In addition and to be briefly touched upon here, a very important innovation relating to macro-prudential or systemic risk supervision is taking place.

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Thank you very much Mr. President. I am very pleased to expose to you a subject that is keeping me and many other people very busy these days, which is the revision of the financial supervisory system. It is a great occasion to present, once more in Milan, the views that are being developed at the European level. I was asked to deal with the "European Supervisory System". I will only develop the micro-supervision, which is the supervision on banking, insurance, pension funds and securities markets. In addition and to be briefly touched upon here, a very important innovation relating to macro-prudential or systemic risk supervision is taking place. In November an agreement was reached at the European Council about the organization of the "European Systemic Risk Board"(ESRB). That Board would be composed essentially of the Central Banks, with participation of the Supervisors and the Commission and would identify the significant developments in the financial system that may cause systemic risk, probably not only in Europe, but also in a wider context, calling for cooperation with the US. This Board will obtain its information, apart from its own sources essentially from the three supervisory authorities that are in fact the successors of the present Committees. It is controversial to what extent the ESRB would have direct access to the information at the individual bank level, as this may create difficult questions of secrecy, confidentiality and competition. What is this Board going to do? It will not give binding injunctions, nor will it give strict orders. It will make recommendations addressed to the European authorities, to the supervisors in the different jurisdictions, the different European states. These recommendations are expected to be implemented at the national level. It is being understood that if no implementation comes forward the matter will become a question of a political nature, which means the Supervisors will have to explain to the European Systemic Risk Board why they have not implemented a recommendation and if such explanation would prove unconvincing, the only way out is to raise the question at the political level, at the level of the Council. At the Council, that Member state will have to explain why it has not given response to a particular ESRB recommendation and if needed the Council will take decisions with qualified majority. So after this short introduction on the ESRB, let me turn to micro-supervision, the original topic of my presentation.

My presentation will be divided in two parts: first I will give you an over-pessimistic view of the present situation, but let me stress that it is over-pessimistic. I mainly identify all the flaws, the weaknesses of the presently proposed system in order to contrast them with the virtues of the future system, as I hope these will be realized with the present reform.

The present system is very much bottom-up: it is based on the cooperation of the existing national supervisors, or the level where the ultimate regulatory and supervisory power is located, notwithstanding the coordination at the European level. This coordination is the work, first and foremost of the European Directives and Regulations, the so-called level 1 instruments establishing the basic policy rules, and the level 2 directives or regulations, being the implementing provisions. The latter instruments are adopted by the Commission after a decision in a committee, in which the member states are represented. It is in fact a short form level 1 process.

The present regulatory apparatus suffers from its wide diversity: it is not because the Union has decided on a certain matter in a level 1 or level 2 instrument that the way the national legislators or regulators will implement this instrument will be largely similar. Today we see large differences in the national laws, due to different traditions, different needs, but also to a strong will to better protect the local market participants (so-called goldplating). The final outcome is a far from homogeneous system, failing to realize the internal market for financial services. Moreover, apart from differences in regulation, there are also wide differences in the way rules are actually being implemented: even where a - directly applicable - regulation, like

on prospectuses has been in place, there are substantial differences in the practical outcomes, some national supervisors being more demanding than others. This results of course in some form of regulatory arbitrage, whereby the most accommodating supervisors will be sought after by the financial intermediaries, irrespective of the effects on the overall markets, or the protection of the interest to be protected.

The drive for further effective convergence and coordination has been introduced on the basis of the Lamfalussy Report, proposing better coordination through the functioning of a committee of national securities supervisors. CESR, or the Committee of the European Securities Regulators, which is located in Paris was created on that basis in 2001, with essentially a role of advisor to the Commission. However, based on the pre-existing cooperation between the then 15 supervisors, the coordination function slowly became more prominent, leading to the formulation of common policies and views. These policies were expected to be implemented by the members, and to be verified in the framework of a Peer Review procedure, the outcome of which might be published ("name and shame").

Notwithstanding the intention to act as a coordinating committee and although its decisions are usually taken unanimously by the 27 members, there is no guarantee that these decisions will also be followed at the national level. CESR recently undertook extensive efforts aimed verifying this point – review the implementation of the main directives, Market Abuse, Prospectus, Transparency and Mifid, but also its own standards. The results of this enquiry are far from satisfactory: national regulators and supervisors have difficulty putting their national apparatus in line with the European policies or decisions. Two questions need therefore to be answered: a horizontal one, or how to ensure that all national supervisors agree on the same practices and rules, and a vertical one, how ensure that the national supervisors adapt their national regulatory system and practices to the commonly agreed rules and standards. Moreover, it appears that especially for cross-border institutions, supervisors have not always the same opinion on how to proceed. In the absence of a clear mechanism of binding decision making, difference of views remain unsolved, which means in fact that each of the supervisors implements its own views. For cross-border financial groups, one can see easily the difficulty of having not only to cope with several supervisors, but in addition having to adapt to different instructions, from different national supervisors. Although to some extent this diversity flowed from the directives themselves allowing for many national options and discretions, in other cases differences were due to national goldplating, or event simply deficient transposition and implementation.

In 2004 this approach was extended to the banking and to the insurance regulators: hence the creation of the Committee of European banking Supervisors (CEBS) and of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), located in London respectively Frankfurt.

According to the present system the national supervisors pursue national interests and will be held accountable to their national authorities (governments, parliaments) if they divergence from that objective. However in a European perspective, their decisions should also take into account the interests of other Member states that may be directly affected, or the interest of the European union as a whole. If one state introduces a favorable regime for deposit guarantee, that decision will affect the deposits in the other states, from where the deposit will be transferred to the first state and create serious imbalances if not other risks. This kind of decisions should not be taken before due consultation with the other affected jurisdictions.

It will not astonish that Mr. de Larosière concluded that the supervisory architecture needed "repair". Repairs are numerous and overdue.

In institutional terms, an important part of the new regulatory structure consists of the upgrading of these, today essentially advisory committees to European "authorities", endowed with the power to make binding rules and decisions, act to insure implementation of the directly applicable rules, mediate in case of conflicts among supervisors, and if needed, take emergency measures. In fact these are the four areas in which the authorities will in the future be able to exercise "binding" powers. According to the proposed system the future authorities will be empowered to adopt an increasing number of binding regulations, called "*technical standards*" in the areas that have been identified in the specific directives, but they will also examine whether the national systems have *adequately transposed* the European rules, in which case they may act against the national supervisors and even against the firms that are not complying with the European standards or instructions. In addition, the authorities would also have the power to *settle disputes* between supervisors, not as arbitrators but as mediators, if these supervisors adopt different attitudes with respect to a specific issue. This is likely to be quite important in the framework of the functioning of the today already existing colleges of supervisors for all large cross-border banking and insurance groups. Finally, the future authority would also have emergency powers, but only after the emergency has been declared by the ESRB, according to the procedures provided for in the- not yet final - regulation on the authorities

Up to now the proposals provide that the same basic regime will apply to the future banking, insurance and market authorities. Little account has been taken of the different needs of each of the authorities, especially the market authorities where decisions often have to be made very rapidly. In addition, the market authority will be the first to exercise effective supervisory powers, i.e. on the credit rating agencies. Therefore as the powers and the realities of supervision are different, a differentiated treatment is unmistakably necessary.

For a good understanding it is important to be aware that this type of European action only extend to the four fields indicated, and that it does not extend to actual day-to-day supervision, as this will essentially remain national. The banking supervision will therefore continue to be exercised by the Banca d'Italia, not by the future European banking authority, but however increasingly according to EU wide standards or rules. One important exception concerns the supervision of the credit rating agencies, which for obvious reasons – there are essentially only three, US domiciled agencies – is better centralized and exercised at the central level, with a system of registration effective all over Europe and taking into account the similar regulations and authorizations in the US. This regime has been introduced by the Council in a directly applicable regulation, and has to be made operational in 2010 in an amendment to the CRA regulation, whereby CESR – or better ESMA – will be put in charge of this supervision. But apart from this case, the motto is "central rulemaking, local supervision", whereby central means, increasingly at the European level, and local refers to the national competences.

A subject that is also likely to receive some attention, especially in the political debate, is that of the centralization of the different committees. It may seem odd that the new structure will still be split over three pillars, and that, as wished for by some, no single overarching body will be created. Although in the most recent proposals from the European Parliament, the issue of the seat of the authorities has been left open, it would be very astonishing that any change would intervene on this point. It would be a terrible waste of time to start negotiating again over changing the present situation, if one remembers that in 2004 it has taken at least

one year to agree on the location of the committees. Now that the discussion would deal with "authorities", member states would certainly redouble their efforts! And the crisis urges us to fight the real battles.

Sometimes it has also been questioned whether the existence of three committees does not constitute a handicap now that the structure of supervision in Europe is very diverse, some countries having split supervision over three pillars, other over two ("twin peaks"), while in a third group one finds the integrated supervisors, where all supervision is centralized n in one institution. In practical terms however, this question solves itself: already today, specialized representatives from the institutions take part in each of the three committees. Only the integrated supervisors have sometimes difficulties in spreading their efforts over the three committees, especially if these are working according to different rules. In the future, that structure would remain, so that integrated supervisors would be present in all three authorities, twin peaks supervisors would be separately represented in the markets authority and in the banking and insurance authority. This often also corresponds to the internal skills and mindsets.

However this does not mean that there should not be strong cooperation among the three committees as is already the case since several years. In our jargon, this is the 3L3, the three level 3 committees, which is a voluntary but effective cooperation between the three committees. Under the present regime they have been working effectively and adopted on many points a common position, or engaged in cross-sectoral work. In the future, the structure will be strengthened, it will have clearer governance, a stronger secretariat, but the basic set up of cooperation will remain the same. In the political world it is often felt that more should be achieved in this field: one must admit that the number of items of cooperation between the prudential supervisors (banking an insurance) is much more significant than between these two and the market supervisors. Quite important cooperation projects related to organization matters – one sees delegation matters, or sanctioning rules as significant developments here - while an ambitious common training program has been set up.

The governance of the new institution calls for a lot of attention. In principle the governance will be quite simple, and comparable to that of a private company: a general meeting, a board, and an executive. The general meeting – the Board of Supervisors according to the proposal- is, like today in the committees, composed of the representatives of the national supervisors, in principle its heads. Hence it is composed of 27 members, with full voting rights, and 2 observers from the EEA countries. The Board of supervisors will act by majority of its members, except in matters of a regulatory nature, where a qualified majority will apply. One can suppose that as in the past, the Board will act by consensus, which was defined in CESR's charter as unanimity minus one or two!

The Management board will be composed of six elected members, and the chair. They will essentially prepare the meetings of the Board of Supervisors, and execute its decisions. The possibility of delegation has been provided. The chairperson will be an independent person, meeting the demanding criteria laid down in the regulation. He will be elected by the Board of Supervisors, on the basis of an open procedure, and his election has to be confirmed by the Parliament. His task is to direct the authority and make sure the governance mechanisms function as provided. The executive director is in charge of the day-to-day functioning of the authority and the entire internal administration. He too will be elected by the Board of Supervisors. All in all the structure is quite open and democratic in the sense that the residual powers lie with the Board of Supervisors, thus the national supervisors, thereby maintaining

the cooperative structure of the present CESR. This is an important element of trust among the national supervisors.

The place of the other European institutions in this set-up is most of the time limited to an observer status. This is the case with the Commission, which will be present in all bodies with an observer status, as it is the case today. However for budgetary matters, the Commission will have a say. This is understandable as according to present previsions, the Community budget is likely to contribute substantially to the functioning of the committees, along with a contribution from the national supervisors (in a 40/60 proportion, as proposed in the Council statement) .The representatives of the ESRB and of the other two committees will be present by delegating an observer.

It is important to highlight that in the future, as is the case today, the procedures applied within the authorities will be very transparent both v.a.v. the European institutions as v.a.v. the public. As today, there will be large public consultations on all important subjects, both written and in the form of hearings, and a continuous dialogue will be kept with the markets and all actors engaged in them. There will be also a consultative panel -of thirty members- representing the different groups active in the markets. The Parliament proposed that at least 5 academics should be part of it, and not more than 10 representatives of the market participants. This means that there will be a large room for the different classes of "buy side" representatives, investors, both retail and institutional, while shareholders and listed companies will also have a stronger presence in this panel.

The process for the introduction these authorities is in full swing. The Council reached a "presidency compromise" on the 2nd of December 2009. The Parliament has started its work and the proposals of the rapporteurs – there is one for each authority – have already been published. Comparing with the Commission proposal, the Council has deleted some quite substantial aspects mainly dealing with the refusal to see the European authority intervening in the functioning of the supervised firms. This would result in a two tier supervisory system, whereby the decisions of the authority would be binding for the national supervisors, but the authority could not verify nor enforce whether that national supervisor enforces the rule against the firms subject to its jurisdiction. However the regulation contains no clarification as to how the authority will ensure that the national supervisor implements what it has decided: this can be quite crucial, e.g. in cases of mediation, where the national supervisor will not necessarily be very satisfied with the decision. Hence there is a definite risk that decisions will remain a dead letter. The proposal of the Parliament for ESMA contains a remedy consisting of allowing the authority to sue before the national court: as the regulation or decisions are an integral part of national law, it should be possible to submit the matter to the national jurisdiction, that could decide taking into account its rules on procedures, on due process, and on sanctioning. The national court could eventually submit a prejudicial question to the ECJ, as is already the case today.

At the moment of writing, the texts change quite rapidly, and that before Parliament and Council reach a common position. It is expected that the regulations will be adopted in the first half of 2010, and that the authorities will become operational starting beginning of 2011. Between now and then, a considerable amount of preparatory work will have to be undertaken.

To conclude.

The creation of the three authorities will constitute the beginning of an important evolution in the supervisory financial architecture in Europe. Even if the powers today are still relatively modest – according to many too modest – it is important that an institutional mechanism is put in place that will serve as a reference point for much of the developments in the future. On the other hand the present legal structure, and especially the Treaties do not allow to create real supervisory authorities. This weakness will have to be remedied in the future. But we should now start with what is achievable, not with what could possibly be done. Institutions live their own live and it seems to me that over another so many years, the stepping stones that have been, and will be laid this years will constitute the basis for the construction of a more solid and vast building. With the grave financial crisis in mind, we have no choice but to succeed.

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