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Abstract

Now that most of the regulatory measures have been taken to implement the Financial Services Action Plan, attention is drawn to the implementation of the numerous directives and regulations that have been enacted. New techniques leading to more regulatory convergence are being developed. The Committee of European Securities Regulators has recently published an outline for more convergence, both for rule making, but also for supervisory convergence. Home and host issues are of central importance here. As integration moves forward, there is an increasing need for rebalancing the distribution of competences between national cooperating supervisors..

Developments in European Financial Regulation

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1. New techniques of regulation

1. Developments with respect to financial supervision in Europe are in full evolution. Some of these developments are directly linked to the implementation of the Financial Services Action Plan[1], the ambitious plan the Commission launched in 1999, in order to create a fully integrated internal financial market. The measures proposed not only aimed at abolishing the impediments and barriers that limit financial transactions among Member States, but heavily stress the introduction of harmonisation measures that would help create a level playing field, according to the Commission analysis, the indispensable prerequisite for the creation of an effective internal market. Of the 42 measures proposed, 39 have been adopted as of half 2004, what undoubtedly is to be considered an impressive achievement.

At present, implementation of these measures in the national legal systems will keep authorities engaged for a few more years. Implementation involves two levels of activity: regulation on the one hand, consisting of transposing directives, or where necessary, complement regulations, supervision on the other hand, aiming at the efficient enforcement of the European rules. Therefore, there are two distinct steps: regulatory action and administrative supervision. Each raises specific issues, which I will briefly explain.

2. An important instrument in the further realisation of the FSAP consists of the so-called Lamfalussy-scheme[2]. It aims at streamlining the future decision-making techniques, especially at the regulatory level. The scheme is based on the introduction of four levels of action: level one is the legislative work of Council and Parliament, acting on the proposal of the Commission. These are the traditional directives, that, at least according to the wishes of the draftsmen of the Lamfalussy report, would be limited to the principles of the regulation, rather than dealing with detailed prescriptions.

Different from the previously very detailed directives, this new generation of directives is supposed to formulate only the general principles, and delegate the detailed implementation to the different regulatory committees, which will be declared operative in the three main business lines, i.e. banking, securities and insurance. This regime of delegated rulemaking may seem innovative. In fact, known as "comitology", it has been practised in several other fields[3]. In each of the three fields concerned, two committees have been created, a regulatory committee composed of the representatives of the national ministers of finance, and an advisory committee, composed of the national financial supervisors. Under the chairmanship of the Commission, the regulatory committee approves the implementing legislation that enters into force without any further decision of Council or Parliament. The legal basis for the delegated regulation has to be found each time in a specific provision of a directive as approved by Council and Parliament.

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1 FSAP of May 11 1999 (http://www.europa.eu.int/comm/internal_market/en/finances/actionplan/)

2 For the Lamfalussy Report, see Final Report of the Wise Men on the Regulation of European Securities Markets at http://europa.eu.int/comm/internal_market/securities/lamfalussy/index_en.htm

3 The principle governing comitology were coordinated in a Decision of 1999 (Decision 1999/468/EC of the Council of June 28 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission, OJ L 184, 17.7.1999, p. 23)

This legislative technique can be best compared to the secondary legislation, enacted by the national government, pursuant to an act of Parliament. It is customary to refer to this kind of delegated regulation as "level 2" work.

The three advisory committees, composed of representatives of the national supervisors in each of the fields concerned, advise the Commission on the substance of the implementing regulation. Technical knowledge of the issues involved is mainly available at that level.

Cooperation among national supervisors mainly takes place within these advisory committees. This is the so-called level 3 work, leading to the exchange of information and experiences among supervisors, and the agreeing of conduct rules that the supervisors are expected to use as the source of inspiration for establishing their own national regulations, or supervisory action.

Level 4 concerns the enforcement of the European legislation in the member states. Based on art. 211 of the Treaty, it mainly concerns action undertaken by the Commission against a Member State who has not lived up to its obligations under the directives.

3. In the field of securities, already in 2001, the Commission established the European Securities Committee and the European Committee of Securities Regulators or "CESR"[4]. Both have realised a significant amount of work in preparing the implementing regulation on the basis of the new directives, especially those on market abuse, prospectuses and investment services[5]. A first series of implementing acts, whether under the form of directives or as regulations have thus been adopted according to this accelerated procedure. The preparation time for this new regulatory apparatus ahs been considerably shortened. The volume of regulatory provisions however has been significantly increased.

The first implementing regulations by way of European directives and regulations have been:

- Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments[6];

- Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation[7];
- Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest[8];
- Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive

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4 Created by Commission Decision 2001/527/EC of 6 June 2001 establishing the Committee of European Securities Regulators, OJ L 191 of 13.07.2001, p. 43.

5 Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, O.J. L 145, April 30 2004, p. 0001 – 0044. Hereafter referred to as "Mifid".

6 O.J. L 336, 23 December 2003, p. 0033 – 0038.

7 O.J. L 339 van 24 December 2003, p. 0070 – 0072.

8 O.J. L 339 of 24 December 2003, p. 0073 – 0077.

2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements[9];

4. Similar structures have been introduced in the fields of banking (Cebs)[10] and insurance undertakings and pension funds (Ceiops)[11]. These committees are not yet in full operation: their regulatory competences have to be established in directives, which still have to be adopted. Especially in the field of Basel II, this technique will be especially important. The proposed directive allows the Cebs to adapt the provision of the annex to the directive, containing the detailed rules[12]. A similar development can be expected in the insurance field.

5. These new implementing instruments are directives, as well as regulations. This means that directives of Council and Parliament are implemented by Commission directives or Commission regulations, in the latter case achieving the maximum degree of uniformity in the applicable law. Indeed, regulations are directly applicable in national law. By doing so, the commission attempts to limit regulatory competition, and simplifies the application of the rules by the national supervisors. A similar trend can be noticed as far as the directives are concerned. Where previously, directives introduced a minimum level of harmonisation, leaving sometimes considerable leeway to the states to enact supplementary, often more protective provisions, the new generation of directives establishes maximum harmonisation. In all Member States the same level of regulation has to be introduced, which is binding to the states, and which cannot be supplemented by them. States remain free to decide on the form of the transposition, the precise wording, etc. It is clear that by insisting on increasingly uniform regulation, the Commission strives at creating an integrated regulatory system, preventing states to appropriate competitive advantages, especially by way of a more flexible transposition, or barriers to entry under the form of protective rules. The issue of regulatory competition has therefore been clearly put on the agenda, both for regulation and supervision.

Whether, under this new regime, there still can be considered room for the "general interest" reservation, probably calls for a restrictive answer. Except within the boundaries of the directive, and the general provisions of the Treaty e.g. on the basis of protecting public health or safeguarding the public order (art. 46), national protective or limitative rules are not further permissible.

6. The transposition of European directives, seen against the background of a stronger harmonisation objective, raises a number of new questions. These are receiving ample attention from the securities supervisors, acting within the CESR[13].

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9 O.J. L 149, 30 April 2004, p. 0001-0130.

10 The Committee of Europen Banking Supervisors or CEBS.

11 The Committee of European Insurance and Occupational Pensions Supervisors or CEIOPS.

12 Proposal for DIRECTIVES OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL Re-casting Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions and Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions. http://europa.eu.int/servlet/portail/RenderServlet?search=DocNumber&lg=en&nb_docs=25&domain=Preparatory&in_force=NO&an_doc=2004&nu_doc=486&type_doc=COMfinal

13 CESR, Which Supervisory Tools for EU Securities Markets? An analytical paper by CESR, ref.04-333f – Oct 04.

The starting point of this reflection is that in their national legal orders, the securities supervisors are in fact often closely involved in the transposition of the Directives, as they will have to insure the application thereof in practical cases. As a rule, they have the most thorough knowledge of the subject matter. Cooperation among supervisors is therefore beneficial, in order to identify the transposition questions, to bring to the surface the different answers to be given, taking into account the specificities of each of the legal orders, and, where possible, formulate common provisions. By so doing one could not only make progress with respect to the transparency of the regulation, a feature of great importance to domestic, but especially to foreign operators, but one could insure a more "level playing field", as the same restrictions will be applicable in largely identical formulation in all of the Member States. The approximation of the competences of the supervisors will support the equal treatment of all market participants. The follow-up of the regulatory process, including the later modifications, could usefully be undertaken in the same cooperative process, avoiding national systems to diverge over time. Finally one could also imagine national implementing regulations to be compared in order to determine whether implementation has remained within the boundaries traced by the directive. Instruments such as "peer review" can be considered, aimed at timely transposition and substantive correspondence with the directive. Mechanisms like "mediation" have been proposed: according to this proposal, any individual could complain against any regulator or supervisor. This would unduly increase antagonistic conduct[14]. One could however imagine a procedure, urging supervisors to enter into contact with colleagues of other jurisdictions where divergent implementation has taken place in order to achieve greater conformity with the directive. But, in most cases, one can expect peer pressure to suffice.

The pre-regulatory cooperation is essentially an informal instrument. It leaves the competences of the Commission unchanged. The Commission, acting on the basis of art. 211 of the Treaty, will continue to insist on timely implementation and remains the guardian of the conformity of the transposition. The Commission has an impressive set of arms at its disposal. Therefore its use should preferably be constrained and limited to an "ultimum refugium".

2. Development in the field of supervision in the European Union

7. According to the Lamfalussy-scheme, the above-mentioned advisory committees also have an important task of "supervisory convergence". It is indeed not sufficient that the regulation converges; actual supervisory practice should also tend towards more common practice. This level of activity is designated as "level 3" work[15]. As the CESR was created already in March 2001, it is not surprising that the reflections as to the nature and objectives and instruments for level 3 work are the most advanced in the field of securities regulation. In addition, this development can be linked to the historical origin of CESR, which was born out of FESCO, the Forum of European Securities Commissions, a network of securities supervisors, created in the second half of the nineties. A flexible informal system of exchange of information and cooperation was been created, resulting after a few years in the official regulatory committee, where increasingly policy issues are being debated.

The concrete achievements of this network can be illustrated by referring to the CESR website[16]. A clear illustration of the type of work undertaken is CESR-Pol, probably the most

[14] See the proposal of the Federation of European Securities Exchanges, A professional ombudsman for Financial Services, at http://www.fese.be/initiatives/fese_consultations/ombudsman.htm.

[15] CESR, The Role of Level 3 of the Lamfalussy Process, April 6, 200, Ref 04-104 b.

[16] http://www.cesr-eu.org/

advanced framework for cooperation and information exchange. Within CESR-Pol, supervisors regularly meet to discuss items of interpretation, techniques for tracing and combating illegal activities in financial markets and exchange information on the procedures and investigations that they have actually come across. The exchange of information could be structured by creating a common database, or common action in case of cross border financial scandals could be considered. In other fields too, similar initiatives can be developed: the introduction of IFRS, and the accompanying transitional measures at the level of interpretation can be cited as an example. The deepening of the network function can be seen as an important step into the direction of creating a European scheme for supervisory integration.

2.1. Supervision by the home – or by the host State?

8. Apart from the harmonisation of the supervisory regulations and practices, implying essentially the coordination of the individual legal systems, there are a number of very interesting questions relating to the way cross border supervision should be structured.

The basic European scheme, going back to the landmark case known as "Cassis de Dijon" and the 1985 White book on the Internal Market, is based on "mutual recognition". The rule adopts the position that the regulation of another member state is considered equivalent, and that competence lies with the supervisor competent on the basis of the location of the principal place of business of the enterprise. In principle, said legal system will be applicable to the legal entity as a whole: in this case, one applies the "home" state rule. It applies to the foreign branches of the enterprise and to the services offered by it in another EU state. The latter is then the "host" state. In some regulations, it is expressly required that the company seat is located in the place where the company's principal place of business is located[17]. Mutual recognition applies to all activities designated in the directive. Outside the ambit of the harmonisation directives, the Treaty rules will be applicable. Cross border establishment, or service providing will often call for an additional registration or licence in the host state. This requirement is a permissible restriction on the freedom of establishment as being based on the protection of the depositors, investors, policy holders (i.e. on the "general good" reservation).

In the financial field, mutual recognition is applied to a wide number of subjects, as harmonised by different directives. These relate to banking and insurance supervision, supervision on investment funds, certain transactions in securities (e.g. for the prospectus, used in connection with the public offering of securities, and in the future for take-overs as well)[18]. The mutual recognition is based on the prerequisite that supervisors have sufficient confidence in each other. This explains why mutual recognition is usually linked to a harmonisation directive providing for similar (i.e. harmonised) access and operating conditions.

According to the presently prevailing regime, prudential supervision is linked to the competence of the home state, and covers all activities of the legal person. This regime does not apply to non-EU firms: these are considered separate institutions, even if ran under the form of a

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[17] Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, OJ L 126 of May 26 2000, p. 0001 – 0059; Art. 6, § 2: "Each Member State shall require that: any credit institution which is a legal person and which, under its national law, has a registered office have its head office in the same Member State as its registered office, any other credit institution have its head office in the Member State which issued its authorization and in which it actually carries on its business.

[18] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, O.J. L 142 of April 30 2004, p. 0012 - 0023.

branch. A EU branch of a Swiss bank would therefore have to apply for a separate banking licence. Also, it will not be allowed to take advantage of freedom of establishment: if it wants to establish a branch in another state, that branch will need a licence in that state. But if it chooses to create a subsidiary, this will be considered a EU bank, which can avail itself of freedom of establishment.

There are certain exceptions to this basic scheme. Certain matters are better placed in the hands of the local supervisor. The liquidity position of branches of banks is supervised by the "host" supervisor, as liquidity provision will also be ensured by the host central bank. The same applies to the distribution of financial products such as investment funds: the marketing conditions, but also the specific information (e.g. on tax issues) addressed to the local investors, are better controlled by the supervisor of that market[19]. A general exception to the home state's competence concerns the "general good" reservation. The host state could, in fields that have not been harmonised, require its local rules to be applied, if it deems this indispensable for the protection of the general interest, as it has defined it[20]. Rules of investor protection are considered to belong to the host state's competence, in fact leading to considerable market fragmentation in fields where the retail investors are involved. Each national regulator will apply its own rules, even to services that are offered from abroad, or to firms that are operating multinationally. The e-commerce directive has somewhat alleviated this objection, by giving precedence to the home state, restricting the use of the general good exception. The same reasoning is followed for the regulation of distance selling of certain financial products[21].

9. An important precision relates to the supervisory regime applicable to subsidiaries: as these are separate legal persons, they are supervised in the state in which they are located. Apart from the legal arguments this approach is based on the fact that the parent is not obliged – at least not by law – to stand behind its subsidiary.

This approach has been criticised. The division of powers is based on essentially legal arguments, but does not reflect business reality. From a business perspective, the group is managed most of the time as one single entity. For multinational groups, the choice between a subsidiary and a branch has little to do with solvency considerations, but is a question of relative advantages or disadvantages, without great incidence on the group management. To express this reality, complementary supervision is exercised on a group basis[22]. This falls short however of supervision on an integrated basis, whereby only the supervisor competent for the parent would be in charge of the group as a whole.

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[19] The four party agreement concerning supervision on the Fortis group was explained in CBF, *Jaarverslag 2001-2002*, p. 179.

[20] Art. 27 Directive 2000/12 of March 20 2000. OJ L 126/1 of 26.05.2000.

[21] See art. 3 of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ("Directive on electronic commerce") O.J. L 178 of July 17 2000, p. 0001 – 0016. See also Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC O.J. L 271 of October 9 2002, p. 0016 - 0024.

[22] See the Belgian Royal Decree of August 14 1994, implementing Directive 92/30 of April 6 1992.

Where the supervisory pattern does not reflect economic or business reality, there will be double use of supervisory actions, waste of time and money, and sometimes even contradictory instructions[23].

Therefore, one has to analyse whether this home/host division of competence is the most efficient one.

In fact the local supervisor necessarily will have to rely for a certain number of subjects on the home supervisor competent for group management. This will be especially the case if certain supervisory functions within the group (such as the internal audit, compliance, etc.) are increasingly located at group level. It will be a matter of principle whether groups, which are managed on an integrated basis, should not also be subject to integrated supervision, addressed mainly to the group's central management. Legally, if one would follow this approach, it would call for quite a substantial change in the regulatory pattern, which can only be achieved by a European directive. Matters like the cross border enforcement and inspections, the access to data located in another jurisdiction (including the questions flowing from banking secrecy laws) divergent instruments and methods for supervision, liability questions, matters relating to deposit guarantee systems or lender of last resort issues, will all have to be settled. Supervisors will be very loath to march into that direction unless obliged to by the financial institutions themselves. This threat may increasingly be used once bank or insurance companies can take advantage of the European Company Statute to merge their subsidiaries into the parent company, shifting supervision away into the hands of the sole parent supervisor.

10. In order to reduce the burden of supervision, and meet the needs of multinational financial groups, certain supervisors have entered into agreements to better coordinate their supervisory action. These agreements usually referred to as Memoranda of Understanding, reflect different degrees of coordination. At least the information has to be centralised at parent level and redistributed to the supervisors competent for the subsidiaries. Specific supervisory actions can be coordinated and implemented on a joint basis. Common inspections should also be mentioned. According to the provisions of certain directives, the supervisors involved could delegate certain supervisory tasks. However, as the liability matter has not been settled, this possibility has very rarely if ever been used. As a consequence each supervisor is bound to exercise its own competences in full, if possible in understanding with his fellow supervisor. By way of example one can refer to supervision of Euronext, a group led by a Dutch holding company, owner of several subsidiaries each running a securities or derivatives market in five European states. Supervision is exercised in each of these markets by the local supervisor. Their action is coordinated on a contractual basis, leading to joint exercise of each supervisor's individual supervisory powers.

11 In the field of financial conglomerates, the issue of coordination of supervision – both national and cross border – is raised with particular intensity. Conglomerates are mixed financial groups, composed of banks, insurance companies, investment firms, and all other types of financial services business. Both banking and securities supervisors have to be closely involved and coordinate their action.

[23] This concern is reflected in, amongst others, the positions of the European Financial Services Round Table: Harmonisation of Regulation and Supervision of the European Financial Sector, Oct. 2003, at http://www.efsrt.org/efsrt/index.html.

In order to meet the need for coordination, it has been proposed to designate a "chief supervisor", being the supervisor in charge of the parent company. This supervisor could exercise its competences on the group as a whole but only after due input and concert action from the host supervisors. This function is often referred to as the "lead", a notion that calls for further analysis. The lead supervisor could address the whole group, while the "host" supervisors would, depending on the applicable scheme, only have information rights, and a limited say except in matters of essential importance to them. This approach clearly reflects efficiency considerations: if wide competences would be entrusted to the lead supervisor, the efficiency will be increased. But the opposite is also true: maintaining substantial competences of the host supervisors comes at the expense of more coherent, more efficient supervision. Ultimately it is paid for by the supervised entity. Between the Belgian and the Dutch supervisors, such schemes have been agreed relating to supervision of the bank-insurance group Fortis.

The directive on financial conglomerates also reflects part of this perspective. It enumerates a list of tasks of the "coordinator", who is in charge of information gathering and of the overall evolution of the conglomerate. It extends to prudential capital requirements, at group level, to the intragroup transactions, to structural issues of organisation and internal control. The designation of the coordinator takes place on the basis of objective criteria, and includes the respective national supervisors (i.e. bank and insurance, at present under one roof in several European jurisdictions). Also, additional tasks can be delegated to the coordinator by decision of the college of supervisors[24].

A further reaching delegation of supervisory competences is usually frowned upon by the supervisors. Objections are based on the rights of the supervisors in each jurisdictions, the protection of the interest of the local economy, of the local investors or consumers. Without a legal basis in a directive, coordination will remain restricted to the coordination of the individual actions of each of the supervisors involved.

2.2. Doubts about the basic scheme

12. Recently, a discussion has emerged about the use of mutual recognition as the basic device for attributing supervisory competence. There are important limitations – some will say imperfections – in the technique: it only covers matters that have been the subject of harmonisation directives, and not the entire field of activity. Important subjects such as securities clearing and settlement have been left outside its scope, and deserve urgent attention and rationalisation[25]. Up to the ISD II, the same applied to the stock exchanges – market operators according to the Mifid – for which henceforth specific rules apply. "Oversight" by the

[24] Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council, OJ L 35 of 11.02.2003, 1-27. Art. 29 (2) of Directive 2000/12/EG (the coordinated banking directive) provides the "home" supervisor with a delegation power to carry out verifications concerning branches situated in another Member State. The supervisory authority of that Member State must either carry out the verification itself, or else allow the authorities that made the request to carry it out. Art. 24 (2) of Mifid contains a similar delegation power.

[25] Communication from the Commission to the Council and the European Parliament - Clearing and Settlement in the European Union - The way forward COM/2004/0312 final http://europa.eu.int/comm/internal_market/financial-markets/clearing/index_en.htm

central banks has equally been left outside the harmonisation field: in the absence of any agreement about coordination on these points, each national central bank freely decides about the position it will take in case of crisis, and whether it will step in as lender of last resort.

13. In some member states, strong pleas are heard to expand the reach of the host competences, at least for certain fields of supervision. These concern not only products, but also the supervision of branches, or of cross border provision of services. In these matters host supervisors would like to be able to exercise closer supervision, especially in the cases in which these branches are of such importance to their domestic economy that the supervisor cannot allow to entirely rely on the control activities of its home colleague supervisor. In case of crisis, the question arises who will take the lead if a systemic risk is involved: if this crisis touches state A, will the bank originating in state B be rescued by A, or by B? And what if ultimately the treasury has to step in: will the tax payers of state B be called upon to reimburse depositors in state A?
If the home country rule is extended to deposit guarantee systems, the home state will have to sustain unwarranted charges, as only depositors in that state would have contributed, or there may be corresponding windfall profits in the host state. All this points to the need for a readjustment of the system.

Similar questions arise for the cross border provision of services, e.g. for the execution of securities orders, or for securities settlement systems: is only the home state entitled to claim competence?

In this debate only a reference can be made to the Treaty's subsidiarity provision.

In a certain number of documents, increasing hesitation is being displayed about the mere application of the home/host concept. In fact, this development is a direct function of the increasing integration of financial business in Europe. With the increasing importance of cross border activities, the simple rule of home/host as the only technique for attributing competence will not always offer sufficient "regulatory comfort" in each of the jurisdictions concerned. It is not a surprise that in the Northern states, and in the Benelux as well, early attention has been drawn to these subjects, and that some original solutions have been worked out.

14. Abandoning the classical home/host rule for coordinating supervision in Europe does not come without a price. Indeed, maintaining the supervisory competence of each of the national supervisors will inevitably lead to a superposition of national supervisory actions, creating unbearable pressures and cost for the supervised entities. Hence, increasing calls are being made from the side of business for more centralisation. In the milder forms, these calls refer to the "single entry point", being the designation of one supervisor to whom the firm can address all its supervisory questions, thereby indirectly informing the assembled supervisors, competent for certain parts of the group. In the stronger form, reference is made to the "lead regulator" or supervisor, exercising competences over the whole group. Said schemes could be followed both on the national, and on a cross border level: regional supervisory schemes could be developed among these supervisors that are directly in charge of the main components of the group. Others prefer a more centralised approach, some already dreaming about a single European supervisor[26]. The question of full centralisation and creation of a new supervisory body will raise considerable political debate. At the creation of the European Central Bank, some of these

[26] This possibility was also considered in the Lamfalussy Report, as a measure of last resort, if the other solutions proved to be unsatisfactory.

issues have been discussed, and centralisation was refused in the §§ 5 and 6 of article 105 of the Treaty.

15. The question should not be put in these absolute terms: it is not whether the local supervisors should be maintained or not, or whether a dramatic switch should be made to a single European supervisor, but the question is rather what are the intermediate solutions that may be developed between the existing alternatives, between all "home" or "all host" for purposes of mutual recognition.

In fact, beside the existing classical scheme, one finds already several other schemes. These are of a more recent date and have not been tested as far as their efficiency is concerned. One will also have to admit that not all schemes will necessarily have to be the same in all fields of supervision. At present, there are already substantial differences, whereby for the same institutions – banks, insurance companies – different choices have been made depending on whether prudential objectives are involved, or rather whether the matter is one of systemic stability, a subject for which more room is likely to be made for a local input, as financial consequences will have to be supported locally.

The prospectus directive has adopted the principle that supervision on the prospectus will be exercised by the supervisor of the state in which the issuer has its registered office. For some bonds however, the issuer is at liberty to address himself to the supervisor in the state where the securities will be offered for investment, or where the regulated market is located on which the bonds will be traded[27]. This scheme derogates from the traditional home/host scheme, allowing issuers to address themselves to the most efficient supervisor, not necessarily the least demanding, as this supervisor will be held accountable by the market in terms of reputation. By so doing, the directive organises a certain competition among the supervisors. Competition is important, also among supervisors, as it stimulates them to adapt to market development, to be innovative, and combat administrative red tape. Over time, one may not exclude that this rule may lead to concentration of supervisory activity on prospectuses in the hands of the supervisors responsible for the largest secondary markets. Other supervisors will be at risk to see their position weakened. If this trend would spread to other fields, one may fear a loss of efficiency and expertise for certain supervisors, raising the question whether all European supervisors should maintain all supervisory activities, and expertise. Answers, whatever they may be, should be market driven.

16. The Mifid[28] continues the mutual recognition system already adopted in the ISD for organising the supervision on investment services[29]. As a rule, supervision is exercised by the supervisor where the service provider is located[30]. With respect to certain points, this principle is set aside. One was already accepted in the previous directive, the ISD: it relates to the conduct of business rules. Here the host regulator is competent for activities of foreign firms, offering services on its territory. The rule has been inspired by investor protection motives, as well as for

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[27] Art. 2 (1) (m) of the Prospectus Directive (Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC), OJ L 345, December 31 2003, p. 0064, which is especially important for euro-bonds.

[28] Directive 2004/39/EC.

[29] Art 36 (4); art. 4 (20) (b) in the case of a regulated market, the Member State in which the regulated market is registered or, if under the law of that Member State it has no registered office, the Member State in which the head office of the regulated market is situated.

[30] See art. 4 (20) (a) Mifid.

reasons of level playing field. The underlying reasoning goes as follows: on a certain market, the different providers of services cannot be held to different conduct rules. This would create grave inequalities, falsifying competition. Investors will feel lost if similar products are being offered at substantially different conditions. Therefore, it was decided that the local market rules would prevail. The drawbacks cannot be underestimated: it leads to national regulators being able to shut off their local markets, while new entrants from abroad are faced with considerable implementation costs, which moreover will be different from state to state. Competition between regulations is necessarily curtailed. But once the products are offered on the internet, the rule does not further apply[31]. It illustrates that with the increasing use of electronic communication, also by end investors, the existing approach cannot be further upheld.

These arguments obviously have not convinced the directive's draftsmen: they have rather – rightly or wrongly - considered that the conduct of business rules will increasingly be harmonised, leading to gradual disappearance of the need to call on local, protective rules. One can in this context refer to the rules established by CESR, relating to the "protection of the investor". The choice between investor protection and market integration will be increasingly challenging.

17. Coordination of supervision on "market operators[32]"– i.e. the stock exchanges – has been spelled out in the directive in terms that are different from the basic home/host scheme. In principle "market operators" are supervised by their home supervisor, being the state where the operator is registered or has its principal place of business[33]. This supervision extends to the operator and the services it offers on a "remote access" basis in other member states, using electronic communications devices[34]. The home supervisor will include in its supervision the trades that are realised by the traders active in other states where trading screen have been installed.

The directive does not provide – and this obviously has not be wanted by its draftsmen – that supervision should extend to the subsidiaries of the market operator in other member states. The directive does not organise its freedom of establishment by allowing branches to be set up in other States. Hence, the treaty provisions will apply, leading de facto to declaring each of the supervisors, where branches are established, equally competent, hardly a satisfactory situation.

Why this derogatory regime has been adopted is not easy to understand. One can perhaps find an explanation in the host states' desire to be involved in the supervision of a market operator, active on its territory, that is per hypothesis taking up an important part of securities trading in that state. However, the reasoning is not very convincing as the rule applies without regard to the volume of the cross border business, and as especially an exception has been made for trading on a remote access basis. The present structure of the remote part of that market segment can probably lead to a better explanation of this rule.

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31 See the Directive on e-commerce and financial services 2002/65 of 23 September 2002.

32 Called a "regulated market" being a system, not a legal entity according to the Mifid, see Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, *Official Journal L 145 ,* 30/04/2004 P. 0001 – 0044.

33 Art. 4 (20) (b) Directive 2004/ 39, nt. 3.

34 This is obviously considered the most important option: art. 42 (6) of Directive 2004/39, nt. 3. The system of notification between supervisors is imposed in this case as well.

The directive contains a further exception to the home/host mutual recognition principle. If trading on a remote basis in the host state develops to a volume warranting involvement by the host, the Commission will make a finding, the directive provides, following a comitology decision making process, that the supervisors involved will have to agree to "proportionate arrangements"[35]. The finding will have to be based on the efficient functioning of the securities markets in the host state and the protection of the investors there. One could compare the reasoning with the one applying to systemic risks, where the host state interests also have to be more strongly considered on the basis of their impact on the host state. What these "proportionate arrangements" will look like is not known: sufficient to say that hereto the traditional distribution of competence between home and host has been undermined.

18. Another, equally important point of reference flows from the new Basel II Capital Accord. If the regulations flowing from the Accord have to be applied on a multinational, cross border basis, consistency in the approach will have to be pursued: both home and host supervisors will have to agree about the different elements of measurement of risk (e.g. by internal risk models) all over the group. Differently from the European context however, Basel II is expected to apply on a much broader, possibly a worldwide basis[36]. Between these States, no arrangements of the type that can be introduced in the European Union can be agreed on. Hence the Basel committee outlined, in a call to states concerned, a coordination scheme whereby the home supervisor would take up responsibility, with the necessary input and cooperation from the host state. Interesting discussions can be expected in this respect. It seems indeed logical that for the application of the new Accord, the risk measurement instruments are developed by the parent, and validated by its supervisor. The host supervisors should however be involved, and even a certain amount of diversity would be considered permissible.

A similar difficult balancing act will be necessary in the European context, as the future directive, transposing the Basel II rules in the European supervisory system, also will have to take position on the distribution of competences[37]. The traditional European scheme may need to be adopted to ensure that the risks are measured in the same way, whether arising at the parent, or at the subsidiary. Hence a stronger degree of centralisation will be needed, allowing for sufficient involvement of the host supervisors. Whether overall supervision should become centralised, or only in certain, determined fields, could be the subject of further work. It is however interesting to note that these new schemes are being discussed in relation both to branches as to subsidiaries.

The conclusion may be clear: the discussion is far from closed.

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[35] Art. 56 (2) Directive 2004/ 39, nt. 3. "When, taking into account the situation of the securities markets in the host Member State, the operations of a regulated market that has established arrangements in a host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, the home and host competent authorities of the regulated market shall establish proportionate cooperation arrangements".

[36] Basel Committee on Banking Supervision, press release 11.05.2004, www.bis.org/press/index.htm.

[37] Adde: Directive proposal, see note 12.

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