



**Position paper of the Association
of German Banks (August 2002)**

**Regulation, supervision and stability of the European financial market
– A framework for the future –**

The European Union has made considerable progress in recent years on the way to an **integrated internal market**. The launch of Monetary Union, for example, largely completed the liberalisation of capital movements and payments within Europe. Nevertheless, the EU faces further major challenges, with its **Financial Services Action Plan** playing a key role in meeting these.

The boundaries between the banking, insurance and securities sectors are becoming ever more blurred, as the number of financial conglomerates increases. At international level, a trend towards integrated, cross-sector financial market regulation and supervision can therefore be observed. The progress made in information and communications technology is making it easier for new players to enter the market and driving the internationalisation of financial transactions. At the same time, the financial transactions subject to regulation and supervision are becoming more complex. The welcome enlargement of the EU in particular compels us to further develop the current institutional framework, since **institutions** must be able to perform their tasks **effectively** and **efficiently** also in a European Union with 25 Member States.

This means, in particular, that individual institutions should not be given too many different functions. Even if this helped to reduce the number of bodies at EU level, bodies with varied remits, as well as possibly quite different compositions and reporting procedures would be at odds with the principles of transparency, efficiency, constitutional separation of powers and clear responsibilities. Any establishment of new bodies should therefore be considered openly and objectively. At the same time, those in charge at political level should take a critical look at already existing bodies to determine their necessity or suggest any sensible modifications of their composition and remit.

Some countries have already responded to the above challenges at national level. The UK has combined its different national supervisory authorities into the Financial Services Agency (**FSA**). In Germany, the cross-sector Federal Financial Supervisory Agency (**BAFin**) was set up on 1st May, 2002. At EU level, various institutions are currently drafting **proposals for improving the European framework** for regulation and supervision of the financial sector (Eichel-Brown initiative, interim report of the EU

Economic and Financial Committee, hearing held by the European Parliament Committee on Economic and Monetary Affairs). A decision on these is expected by the end of the year.

I. Faster and more flexible legislative processes in the EU

The legislative processes in the EU need to be improved to take account of the changed operating environment. Because of the growing number and complexity of areas subject to regulation, the traditional legislative procedure – as before in the securities sector – is increasingly encountering limits in the fields of banking and insurance too. At the same time, the swift pace of change calls for flexible responses in the marketplace.

The private banks therefore believe that **the Lamfalussy Report recommendations** for securities markets should be applied to the banking sector (expansion of the comitology procedure). The European Council and the European Parliament would then focus in future on adopting framework principles and regulating implementing powers (Level 1 of the Lamfalussy model). Drafting and adopting detailed technical measures should, on the other hand, be left to a **committee of high-ranking representatives of the EU Member States**, presided over by the European Commission (Level 2 of the Lamfalussy model). The same approach should be adopted in the insurance sector. Given the need for a clear and efficient institutional framework, the convergence of the three financial sectors and the forthcoming EU legislation on financial conglomerates, a single body composed of high-ranking representatives of the Member States (e.g. a Financial Services Committee) with responsibility for the securities, insurance and banking sectors would be desirable.

The committee(s) of high-ranking representatives of the EU Member States would be supported in the process by committees composed, like the Committee of European Securities Regulators (CESR), of **high-ranking representatives of the national bodies responsible for supervision**. Possible synergies between central banks and banking supervisors could be taken into account in the banking sector at the same time. It should, however, be remembered that such synergies do not exist *a priori* but depend largely on national organisational structures in the supervisory sector, which have to be respected.

The EU legislative processes should not be accelerated at the expense of appropriate problem-solving approaches or political/parliamentary legitimation for far-reaching decisions. The line between substantively important areas and technical details is not always clear, although the latter sometimes have considerable political or competitive significance. The experience made to date in the securities sector shows quite clearly that any expansion of the comitology procedure must therefore be accompanied by transparent

and comprehensive **consultation of market participants** at an early stage. Market participants can contribute important insights to the consultation process conducted by the comitology committees, as, thanks to their day-to-day operations, it is they who are closest to the issues requiring regulation. The **establishment of a forum for market participants**, similar to that set up by the CESR in the securities sector, is therefore essential in the view of the private banks. Furthermore, transparency and full information in regard to the political decision-makers in the **European Parliament and the Council** must be ensured. In addition, the **Inter-Institutional Monitoring Group's mandate** should be extended to cover the whole financial sector to permit a critical and constructive review of the expanded comitology procedure.

II. Enhanced cooperation between national supervisors as a step on the way to a European financial services authority

A body composed of high-ranking representatives of the national institutions responsible for banking supervision to support EU legislation would at the same time provide an institutional framework for **strengthening cooperation between national supervisors** to a greater extent than hitherto. This would specifically mean an improved flow of information, more consistent implementation of EU legislation, easier assessment of developments affecting the national supervisory sectors and a more intensive exchange of views on supervisory best practice (Level 3 of the Lamfalussy model). The resulting boost to **convergence of supervisory practice** would help create a level playing field for undertakings operating across national borders. The private banks therefore welcome closer, institutionalised cooperation between national supervisors.

Enhanced cooperation between national supervisors in the banking sector – as in the securities and insurance sectors – would, moreover, be an important step on the way to a European financial services authority or a cross-sector system of European supervisory authorities. In such a decentralised **European system of supervisory authorities**, a central “European Financial Supervisory Authority” (EFSA) should be responsible for uniform supervisory rules and practices and for their implementation by national supervisors in the Member States.

It is also conceivable that undertakings which not only operate across national borders but also have an EU-wide dimension could be directly supervised by the EFSA instead of by national supervisors. Undertakings operating only at national level would continue to be supervised by the national members of the European system of supervisory authorities. Such a two-tier procedure – similar to that practised in European competition law – would be in line with the **principle of subsidiarity** enshrined in the EU Treaty.

A European system of supervisory authorities would be in an excellent position to deal with problems such as multiple reporting to different national supervisory authorities, inconsistencies in international supervisory practices, supervisory loopholes or insufficient competitive neutrality in the area of supervision. Furthermore, an EFSA would possess considerable authority in international negotiations on banking supervision rules.

An **EFSA with powers to supervise individual undertakings** will probably only be possible in the medium term, however, since a number of important **conditions** for such an authority – particularly the legal basis – must first be fulfilled. Despite harmonisation of numerous supervisory rules, the EU does not yet have completely **uniform supervisory law** but applies the principle of minimum harmonisation of supervisory rules, whilst allowing discretionary leeway to take account of the special features of national financial systems.

To allow it to perform its job properly, a supervisory authority also needs a set of effective, uniform **sanctions**. These are not yet available at European level, as there is no uniform administrative law or execution law in the EU. There are also considerable national differences as regards the **legal remedy** that has to be granted to supervised undertakings. As supervisory standards (e.g. the closure of an undertaking or the requirements set by capital market supervisors) may have serious consequences under civil law, particularly as regards the settlement of claims for compensation, harmonisation of **civil law** would also be necessary.

Any transfer of supervisory powers to the European Central Bank must be rejected for several reasons. In particular, this would cut off the important **option of a cross-sector European supervisory agency**. In view of the convergence of the banking, insurance and securities sectors, extending the ECB's supervisory remit only in the area of banking supervision would not be a forward-looking move and would also fly in the face of a noticeable international trend towards no longer giving direct supervisory powers to central banks that set monetary policy independently. ECB responsibility for supervision of the insurance sector is rejected by the political establishment, however. With the adoption of the Maastricht Treaty, entrusting the ECB with any tasks relating to the supervision of insurance undertakings was expressly ruled out in Article 105 (6) of the EC Treaty. What is more, supervision by the ECB is unlikely to be politically acceptable to the **non-Eurosystem** countries, which will increase in number in the course of EU enlargement.

In addition, conferring supervisory powers upon the ECB could put its **independence in monetary policy** at risk. As **part of the "trading police"**, supervisors must be included in the constitutional separation of powers and subjected to political control. Under Article

108 of the EC Treaty, the ECB is, however, not allowed to take instructions from EU institutions or bodies, any government of a Member State or from any other body. If supervisory powers were to be conferred upon the ECB, its independence would have to be lifted for this area. This could jeopardise monetary policy independence and, ultimately, monetary stability. Appropriate central bank policy would also be threatened by potential **conflicts of interest between monetary policy and banking supervision**.

III. Establishment of a European Forum for Financial Market Stability

Against the backdrop of the growing integration of national capital markets, the private banks welcome the idea of special European mechanisms to safeguard the stability of financial markets, such as the establishment of a European Forum for Financial Market Stability. The establishment of such a Forum could facilitate the **cross-sector and cross-border exchange of information** in crises and provide a European counterpart to the G 7 Financial Stability Forum set up in 1999 and the Forum for Financial Market Supervision established in Germany in 2001.

The national central banks and the ECB should be an integral part of the Forum. They have information (e.g. on payments processing and on the liquidity of the money, foreign exchange and derivatives markets) that may be significant in system stability terms. Conversely, the central banks could obtain through the Forum important information that they need to meet their responsibility for financial market stability. It would, however, have to be clarified which information is required to safeguard central banks' lender-of-last-resort function. This has remained unclear to date. In view of the growing entwinement of the financial sectors, a European Forum for Financial Market Stability should, however, be **cross-sector** and cover all the relevant industries (securities industry, insurance industry, banking industry). Putting the Forum under the roof of the European Central Bank, e.g. at the level of the ECB's **Banking Supervision Committee (BSC)**, is therefore out of the question.