



CEPR/ESI 2009 Annual Conference

Towards a System of European Supervisory Authorities

Giovanni Carosio, Chair of CEBS

Venice, 25 September 2009

CEBS

Committee of European
Banking Supervisors

Outline

- I. Lessons from the crisis
 - II. The new European Supervisory Authorities
 - III. Meeting the objectives
 - IV. Unresolved issues
- Conclusions

I. Lessons from the crisis

Some lessons are more relevant for the institutional set-up

1. insufficient micro – macro link
 - in risk assessment
 - in design of regulation
2. loss of trust in delegated monitoring
 - by supervisors
 - by rating agencies, securitization agents, auditors
3. banks that are too big to fail / too big to save

(Is there a specific European dimension?)

I. Lessons from the crisis

Insufficient micro-macro link in supervision and regulation

- in risk assessment
 - macro-economic imbalances
 - implications of the OTD model
 - pro-cyclical market dynamics
 - market liquidity and funding liquidity

- in the design of regulation
 - contagion and extreme market conditions
 - countercyclical measures
 - perimeter of regulation
 - cross-sectoral consistency

(Not specifically a European problem)

I. Lessons from the crisis

Loss of trust in delegated monitoring

Collapse of the interbank market, inability to distinguish between healthy and risky institutions.

Loss of trust in risk monitoring delegated to private agents, and to supervisors:

- divergences in the enforcement of supposedly international standards and rules
- “light touch supervision”

(Problem more serious in Europe?)

I. Lessons from the crisis

Banks that are too big (or too complex) to fail

Two different meanings:

- should not be allowed to fail, to avoid spreading panic / contagion
- should be allowed (partially) to fail, but options other than bail-out of the whole group difficult to activate because of inadequacy of crisis management and resolution tools (or incompatibility across jurisdictions).

I. Lessons from the crisis

Banks that are too big (or too complex) to save

- Some banks are too big in comparison to their home country for a bail-out to be possible, leaving depositors in host countries unprotected or imposing burden on host authorities
- Banks that were systemically relevant in more than one country were broken down to national components, which were bailed out separately, putting into question the viability of cross-border groups or the optimality of the solution to the crisis

I. Lessons from the crisis

The European dimension

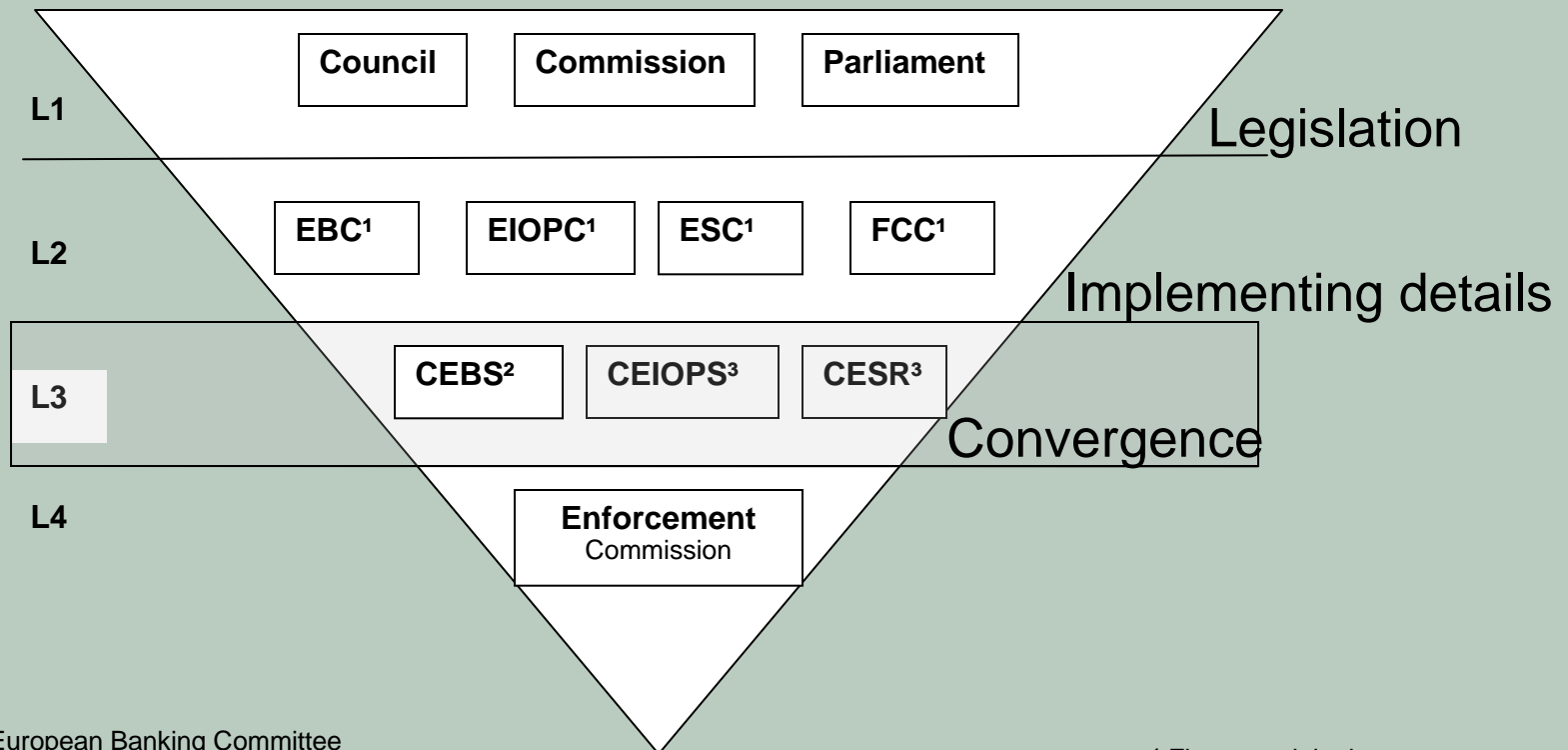
The too-big-to-fail / too-big-to-save problem risks undermining the very foundations of European financial regulation:

- freedom of settlement through branches or subsidiaries
- minimum harmonization and mutual recognition

Government support measures and differing deposit guarantee schemes, while avoiding a melt-down, have created huge distortions, both within and across countries.

II. The new European Supervisory Authorities

The Lamfalussy structure today



EBC = European Banking Committee
EIOPC = European Insurance and Occupational Pensions Committee
ESC = European Securities Committee
FCC = Financial Conglomerates Committee
CEIOPS = Committee of European Insurance and Occupational Pensions Supervisors
CESR = Committee of European Securities Regulators

¹ Finance ministries
² Supervisors and Central Banks
³ Supervisors

II. The new European Supervisory Authorities

The present structure: the role of CEBS

Objectives:

Promote efficient and effective supervision and the safety and soundness of the EU financial system through:

- Good supervisory practices
- Efficient and cost-effective approaches to supervision of cross-border groups
- Level playing field and proportionality

Main tasks:

- Give advice to the Commission
- Promote consistent implementation/application of the EU banking legislation
- Promote convergence of supervisory practices
- Promote information exchange and supervisory cooperation
- Regular risk assessments from a supervisory perspective

II. The new European Supervisory Authorities

The new financial supervisory framework (Commission's proposals)

Two pillars

- ✓ European Systemic Risk Board (ESRB) -> *macro-prudential supervision*
- ✓ European System of Financial Supervisors (ESFS) -> *micro-prudential supervision*

- In this context, the existing 3L3 Committees will be replaced by three new European Supervisory Authorities (ESAs)
 - ✓ **European Banking Authority (EBA)**
 - ✓ European Insurance and Occupational Pensions Authority (EIOPA)
 - ✓ European Securities and Markets Authority (ESMA)

II. The new European Supervisory Authorities

Micro-prudential supervision – The ESAs

The European Supervisory Authorities to:

- ✓ develop binding technical standards in specific areas
- ✓ collect micro-prudential information
- ✓ ensure coordinated activities and supervisory responses in emergency situations
- ✓ promote common supervisory culture and consistent supervisory practices
- ✓ investigate breaches of EU rules
- ✓ participate in colleges' meetings as observers
- ✓ facilitate dialogue, assist supervisors in reaching a joint agreement
- ✓ decide if no agreement can be reached (but no fiscal implications)

III. Meeting the objectives

Micro-macro link

ESRB to identify risks and vulnerabilities, to issue warnings and recommendations, to monitor follow-up.

CEBS to continue and further strengthen risk-assessments and stress-tests
(based on ESCB macro scenarios and on bottom-up analysis from colleges of main banking groups)

CHALLENGES

Two-way flow ESRB-ESAs in risk assessments

Assignment of responsibilities

III. Meeting the objectives

Quality and convergence of regulation and supervision

To achieve a truly single rule-book the EBA will have powers to:

- issue directly applicable binding technical standards in key prudential areas (no national transposition needed)
- issue binding interpretations of all EU legislation, including orders to comply to individual institutions in case of breach
- undertake peer reviews that cover not only convergence in implementing rules and in supervisory practices, but also adequacy of institutional arrangements and resources of national supervisors.

III. Meeting the objectives

Settlement of disagreements between national supervisors

The EBA, on request from one supervisor, in areas where cooperation or joint decisions are required (e.g. on a cross-border banking group), may, after a conciliation effort, take a binding decision.

III. Meeting the objectives

Action in emergency situations

In emergency situations the EBA may require national supervisors to take action to address risks that may jeopardise orderly functioning of markets and stability of the (whole or parts) of the financial system;

In case of inertia, may adopt a decision addressed to an individual financial institution.

CHALLENGES

Complex and lengthy decision making process

Requires EBA to have resources, information

III. Meeting the objectives

Colleges and collection of information

The EBA will:

- participate as observer in colleges of supervisors
- define and collect all relevant information, establish and manage a central system accessible to college members
- have powers to require information directly from individual institutions, if needed.

IV. Unresolved issues

Tools for crisis management and resolution

Proposed framework:

- has potential to improve prudential regulation and its enforcement (crisis prevention)
- cannot solve the problems of crisis management and resolution, because it operates through existing directives.

EU Commission intends to make proposals on early intervention, crisis management and resolution, deposit guarantee schemes.

EU legislation providing supervisors with effective and harmonized tools would make a coordinated restructuring intervention on a cross-border group technically feasible.

IV. Unresolved issues

Clarifying home-host responsibilities in a crisis

Proposals still at early stage of discussion

Contingency planning for specific cross-border banking groups and coordination structures comprised of representatives of colleges, central banks and ministries of finance.

A group structure made of stand-alone subsidiaries could clarify home-host responsibilities, provide implicit burden-sharing criterion, but also impose high efficiency costs on integrated banking groups and hamper the management of the crisis when assets cannot freely move within the group.

For integrated groups alternative ways of providing clarity and workability have to be found.

Conclusions

The agenda of CEBS

- Contribute to restoration of confidence in financial markets
- Avoid a set-back in financial integration in Europe
- Move further on European and global convergence of supervisory practices
- Design tools for the medium-term (EBA)
- Start working immediately with available tools (much can be done)
- Evolutionary model (new structures to develop gradually out of existing ones)

Conclusions

The short-term priorities

- Advice
- on the new Supervisory Architecture
 - on tools for early intervention, crisis management
- Risk assessment
- first stress test on 22 cross-border groups completed; refinements envisaged
- Colleges
- check colleges of cross-border groups up and running by end 2009, written agreements signed
 - new guidelines in 2010: joint risk assessment and planning of supervisory activities
 - CEBS participation in college meetings



CEBS

Contacts:

CEBS – <http://www.c-ebs.org>

Giovanni Carosio

Chair of CEBS

giovanni.carosio@c-ebs.org

Committee of European
Banking Supervisors