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CEPS Commentary
Thinking ahead for Europe
CENTRE FOR EUROPEAN POLICY STUDIES

A bit more clarity, please, M. de Larosière*

Karel Lannoo

3 March 2009

The coming weeks are a crucial period for the reform of the European supervisory system. The recently published report by the high-level group on financial supervision, chaired by former IMF Managing Director and Bank of France Governor Jacques de Larosière, has provided a useful first step, but its proposals need to be clarified and simplified, and their implementation accelerated. The report should lead to a clear roadmap, to be adopted by the EU Council. Some choices need to be thought through more carefully, procedures more fully specified and structures elaborated. Moreover, in our view, serious consideration should be given to amending the EU Treaty to establish a European System of Financial Supervisors – a question carefully avoided by the report.

The financial crisis has clearly demonstrated the limitations of the current EU supervisory model. Financial supervision rests by and large at national level, with a very limited role for level-three Committees, handicapped as they are with the non-binding nature of their decisions, and a mighty European Central Bank (ECB), but whose principal task is to maintain price stability. Supervisory information is not sufficiently shared or consolidated, thereby preventing authorities from seeing the macro-picture. Proposals advanced to enhance European supervisory cooperation, such as the strengthening of colleges of supervisors, have proven deeply flawed in the current crisis, insofar as they are based upon non-binding memoranda of understanding.

The de Larosière report tries to address these shortcomings by suggesting some structural changes. On the one hand, it proposes a strengthened role for the European Central Bank in macro-prudential control; on the other it favours the creation of a European System of Financial Supervision (ESFS). A European Systemic Risk Council would replace the ECB's Banking Supervision Committee, to be composed of the members of the General Council of the ECB, the chairpersons of the supervisory Committees (CEBS, CEIOPS and CESR) as well as the European Commission. It will report to the Economic and Financial Committee (EFC) and the EU finance ministers. By 2011, according to the report, the ESFS will combine the three functional supervisory committees, but at the same time they will become independent authorities. In the meantime, the supervisory committees' role will be enhanced through more resources and more cooperation in order to upgrade the quality of supervision. The report envisions that the ESFS should have laid the basis with the EU institutions for a single rulebook by the year 2013.

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* and a greater sense of urgency!

Karel Lannoo is Chief Executive at CEPS.

While representing a significant step forward, the proposals can be improved in several respects. The role of the ESFS should be enlarged and the timeline for its creation should be accelerated. In our view, the ESFS should consolidate the three authorities – CESR, CEBS and CEIOPS – into a single authority, allowing for efficient and more objective-based supervision, which is a logical solution in a European context. In the meantime, the drafting of the ESFS' statutes should be initiated immediately to allow it to become a truly independent institution, with clearly defined objectives, competences, governance and accountability structures. The incorporation of the statutes into the EU Treaty would provide maximum clarity. In this sense, the ESFS cannot be neutral with regard to the structure existing at national level, as described in the report (p. 48), as this would imply an unclear hierarchy. In addition, the ESFS should have a central role in supervisory data-sharing and consolidation. We believe it is confusing to have two separate, composite bodies dealing with supervision and risk assessment. Risk assessment should flow directly from the hands-on experience in day-to-day supervision.

According to the proposals in the de Larosière report, the ESFS would only be created in 2011, as an umbrella body of the three existing functional supervisory committees, which would be transformed much later into an integrated structure. The roles that the Committees would assume from 2011 onwards, such as formal mediation and delegation of supervisory powers, have been debated since 2004, but apparently the members of the high level group believe still need more time to be implemented. This delay is unjustifiable in light of the flaws exposed in the present system by the crisis. By contrast, the report calls for the immediate creation of the new ECB Council, but this will be an unwieldy body that looks more like a small parliament than a real decision-making entity. Moreover, it remains unclear which among these different bodies will call the final shot, i.e. to decide whether a bank is in deep trouble. The report only says that in times of crisis "the Authorities should have a strong coordinating role" (p. 54), acting as a mere mediator, thus leaving the decision at national level. As evidenced in the case of the UK's Northern Rock, the ambiguous division of labour between authorities stymies the capacity to act in crisis situations, and even more so in an international context.

Another important element missing from the report is a European-wide structure for bailing-out financial institutions, which could have prevented the renationalization of banking markets we are witnessing today. A 'European resolution fund' is an essential corollary of a European supervisory system, and it is regrettable that the report is silent on this aspect.

Hence, we propose that the ESFS should be launched as a single authority from the very beginning, grouping the three supervisory Committees and giving it more competences in the domains of supervisory data consolidation and interpretation, crisis management, supervisory coordination. Work should also begin immediately on drafting the statutes for the ESFS, which would be incorporated into the EU Treaty. The composition of the ECB's systemic risk Council should be more condensed, and the operational relationship with the ESFS more closely defined. A European bail-out fund should also be part of the new structure.