European Commission plans shake up of financial supervision in Europe

Jun 22 2010 Niamh Grogan and Gordon Christian

Financial services institutions and banks, in particular, may well face tougher scrutiny following recent European Commission and European Parliament proposals to create a new system of supervision for the financial sector in Europe. The proposals, which the commission adopted as part of the European Economic Recovery Plan to boost the EU's economy in response to the current financial crisis, appear to be the first steps in a long and highly controversial movement towards giving a single European super-regulator power to monitor banks and other operators in the financial markets such as insurance and pension funds.

The current situation

In the financial services sector there are currently three committees for micro-supervision at EU level: the Committee of European Banking Supervisors; the Committee of European Insurance and Occupational Pensions Supervisors; and the Committee of European Securities Regulators. Widely known as the "Lamfalussy level three committees", they have advisory powers only and can issue non-binding guidelines and recommendations. Technical rules are largely determined at member state level, resulting, some would say, in uneven and uncoordinated supervision.

The proposed new authorities

The proposals, which the commission initially announced in September 2009 and subsequently fleshed out in October 2009, envisage the creation of a European financial supervisory framework. At the heart of such a framework is the European Systemic Risk Board, charged with the task of macro-supervision of the financial system as a whole to detect risks and to issue early warnings that enable prompt corrective action to be taken. In addition, the proposals call for the establishment of a network of financial supervisors, which comprise three new European sector-specific authorities: the European Banking Authority; the European Securities and Markets Authority; and the European Insurance and Occupational Pension Authority. The new authorities would build on the existing powers of the Lamfalussy level three committees, with a number of additional technical powers to:

- Develop proposals for technical standards to ensure more consistent rules and working towards a "common rulebook".
- Settle any disagreements between national supervisory authorities.
- Contribute to ensuring consistent application of community rules.
- Exercise direct supervisory powers over credit rating agencies.
- Coordinate joint responses in emergency situations.

Amid concern that the EU supranational agencies would have a significant impact on national financial regulatory affairs, the commission has been keen to emphasise that the proposals are intended to coordinate between existing national supervisors and not to centralise power. The national regulators would still have responsibility for supervising the day-to-day activities of individual businesses. The Council of Finance ministers from the EU's 27 member states gave the green light to the reform package last December.

The EP's more extensive reform blueprint

Last month, the Economic and Monetary Affairs Committee of the EP voted on proposed amendments which go substantially beyond the commission's current proposals, providing for stronger supervision at EU level.

Under the amendments, the EBA, ESMA and EIOPA would all be based in Frankfurt, Germany (where the European Central Bank is also based), and would collaborate more closely with each other. The EBA, ESMA and EIOPA would be granted new powers, such as being able to draw up draft regulatory financial standards which could then be made legally binding by the commission. The EBA, ESMA and EIOPA would also be given direct supervisory responsibility for systematically important financial institutions, which means that national supervisors would only act as agents of the EU authority. The amended package also provides for a binding mediation mechanism in the event of conflicts between national supervisors. Further measures the ECON committee would like to see to strengthen EU supervision include:

- A greater role for the ESRB before and during crises that affect financial stability. The ESRB would be empowered to develop a common set of indicators to permit uniform ratings of the risk of cross-border financial institutions, making risk levels more easily understandable. The ESRB would be chaired by the ECB president to enhance its visibility and credibility.
- The EBA, ESMA and EIOPA being able to impose temporary bans on very risky financial products.
- The EBA would be specifically empowered to evaluate the accessibility, availability and cost of credit to households and small and medium-sized businesses.
- The creation of two EU stability assisting funds, which institutions supervised at EU level would be obliged to contribute to, depending on their respective risk rating.

If regulatory supervision does ultimately move from existing national regulators to the EBA, ESMA and EIOPA, as proposed, there is likely to be a great deal of resulting uncertainty surrounding the attitudes that the new "super-regulators" will take. As a result, many market participants will be concerned that all the "know-how" that existing regulators have built up about various different aspects of the financial services industry they regulate (which in many cases vary between different member states) may be lost.

Next steps

There are considerable differences between what the commission and the ECON committee are currently proposing. It is expected that intensive talks will now take place between MEPs and the council to strike a balance that satisfies both sides. It is understood that the ECON committee hopes that a deal can be done at the European Parliament's June plenary session, which means that the new supervisory bodies provided for in the package can be set up in 2011.

sjberwin

Niamh Grogan *is a partner in SJ Berwin's EU & Competition Department in London where she advises on both EU and UK competition law matters. Her experience ranges across many industry sectors, in particular retail, telecommunications and financial services.* ***Gordon Christian*** *is a senior associate in the same practice and is experienced in both EU and UK competition law matters in a diverse range of sectors.*