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REPORT

on prudential supervision rules in the European Union
(2002/2061(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Ieke van den Burg

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PROCEDURAL PAGE

At the sitting of 16 May 2002 the President of Parliament announced that the Committee on Economic and Monetary Affairs had been authorised to draw up an own-initiative report, pursuant to Rule 163 of the Rules of Procedure, on prudential supervision rules in the European Union.

The Committee on Economic and Monetary Affairs had appointed Ieke van den Burg rapporteur at its meeting of 15 April 2002.

It considered the draft report at its meetings of 20 June 2002, 10 July 2002, 12 September 2002, 1 October 2002 and 5 November 2002.

At the last meeting it adopted the motion for a resolution by 22 votes to 9, with 1 abstention.

The following were present for the vote: Christa Randzio-Plath, chairwoman; Philippe A.R. Herzog and John Purvis, vice-chairmen; Ieke van den Burg, rapporteur (for David W. Martin); Generoso Andria, Luis Berenguer Fuster (for a full member to be nominated), Pervenche Berès, Hans Blokland, Hans Udo Bullmann, Harald Ettl (for Bernhard Rapkay), Carles-Alfred Gasòliba i Böhm, Robert Goebbels, Lisbeth Grönfeldt Bergman, Mary Honeyball, Christopher Huhne, Othmar Karas, Giorgos Katiforis, Piia-Noora Kauppi, Christoph Werner Konrad, Werner Langen (for Ingo Friedrich), Astrid Lulling, Hans-Peter Mayer, Peter Michael Mombaur (for Renato Brunetta), Fernando Pérez Royo, Alexander Radwan, Mónica Ridruejo, Olle Schmidt, Peter William Skinner, Charles Tannock (for Jonathan Evans), Helena Torres Marques, Bruno Trentin and Theresa Villiers.

The report was tabled on 6 November 2002.

MOTION FOR A RESOLUTION

European Parliament resolution on prudential supervision rules in the European Union (2002/2061(INI))

The European Parliament,

- having regard to the experts' contributions for the 10 July 2002 hearing in the Economic and Monetary Committee of the European Parliament,
 - having regard to the final report of the Committee of Wise Men on the regulation of European securities markets,
 - having regard to its resolution of 5 February 2002 on the implementation of financial services legislation¹,
 - having regard to its resolution of 14 March 2002 on the proposal for a European Parliament and Council directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate²,
 - having regard to its resolution of 14 March 2002 on the proposal for a European Parliament and Council directive on insider dealing and market manipulation (market abuse)³,
 - having regard to its resolution of 14 March 2002 on the proposal for a European Parliament and Council directive on the prospectus to be published when securities are offered to the public or admitted to trading⁴ (A5-0072/2002),
 - having regard to Article 163 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs (A5-0370/2002),
- A. whereas the current unprecedented level of volatility in the financial markets shows conclusively that all financial market participants are facing risk,
- B. whereas the succession of financial scandals in the United States testifies to the failure of the current American regulatory net to prevent financial crises erupting,
- C. whereas there is no evidence at all that Europe is immune to such dramatic crises, all the more so since Europe is going through a transitional phase, leaving fragmented national markets to form a single unified financial market,
- D. whereas the role of financial markets in financing the economy has markedly increased at the expense of traditional forms of bank financing; whereas a growing proportion of household wealth is based on the performance of financial markets; and whereas

¹ P5_TA(2002)0035.

² P5_TA(2002)0112.

³ P5_TA(2002)0113.

⁴ P5_TA(2002)0114.

increasing numbers of employees and the self-employed are relying on financial markets to provide them with a fair old-age pension,

- E. whereas financial markets in the European Union remain fragmented,
 - F. whereas each EU country has established its own financial regulatory and supervisory architecture, based on each country's market structures, history and culture,
 - G. whereas in 2001 the Committee of Wise Men chaired by Mr Lamfalussy proposed a new framework to break the current deadlock in the development of a unified financial market and to institutionalise the dialogue between supervisors at European level,
 - H. whereas the informal Ecofin Council in Oviedo called on the Economic and Financial Committee to assess possible ways of improving prudential supervision in Europe,
 - I. whereas prudential supervisors have to face a formidable challenge in a fast-changing world, namely safeguarding the stability of individual financial institutions and the integrity of the entire financial system,
 - J. whereas in the Brouwer report the Economic and Financial Committee deplored the fact that the level of coordination between prudential supervisors was still inadequate, especially with regard to devising procedures to cope with financial crises,
1. Notes that lax and complacent practices in some companies, especially in the United States, have considerably damaged investor confidence, which proves that public regulation and oversight of financial markets is the prerequisite for financial stability, which ultimately benefits all market participants; notes, however, the importance of ensuring that regulation is proportionate, efficient, risk-based and targeted;
 2. Notes also that Europe has a duty to take into account the recent energetic corrective action undertaken in the United States in the wake of the Enron and WorldCom scandals by strengthening its financial regulatory and supervisory architecture, but also calls on EU institutions to ensure that their response to the Enron/WorldCom scandals is measured, proportionate and risk-based and targets the actual problems/risks; supports the swift reaction of American regulators but would have preferred mutual consultation rounds between European and American authorities at decision-making level before enacting such new laws; calls for a deepening of the dialogue;

National architecture and effectiveness of supervision

3. Notes that each supervisory area (banking, insurance and pension funds, securities, financial conglomerates) faces challenges arising from cross-border and cross-sector activity;
4. Notes that radical organisational reforms can be undertaken at national level only if there is clear evidence that the new structure would carry out its tasks better, as any deep-seated reform entails the risk of disorganising existing arrangements and leading to the loss of precious information; advocates incremental reforms instead;

5. Considers that insurance and pension fund supervision ought to be brought under one roof without prejudice to their specific characteristics; considers that cooperation between existing insurance and banking supervisors should be stepped up, especially where the supervision of financial conglomerates is concerned;
6. Welcomes, in this connection, the Financial Conglomerates Directive, under which an authority has to be designated to coordinate the different supervisors involved in group-wide supervision, acknowledges that memorandums of understanding (MoU) between supervisors are the adequate way to treat financial conglomerates whose activity spreads across a limited number of countries but fears that this form of cooperation shows its limits when facing future conglomerates operating all over Europe;
7. Considers that, at national level, the single, integrated agency approach and the disappearance of the traditional divide between banking supervision, insurance supervision and securities supervision has attractions from an organisational point of view and may prevent cross-sector regulatory and supervisory arbitrage;
8. Notes also that a conduct of business supervisor independent of prudential supervisors is an acceptable alternative (as in the 'twin peaks' approach developed in Australia), as the former's priority is to protect retail investors, whereas the latter may have overriding priorities in connection with preserving profitability and the soundness of financial institutions;
9. Opts to keep an open mind on an optimum national structure; considers that the ability of the national banking and insurance systems successfully to weather the highly volatile environment in the next few years (or not) may give valuable indications as to the relative efficiency of national supervisory systems;
10. Concludes that the focus of national supervisors will increasingly emphasise enforcing rules, that the quality of internal managerial practices matters more than the outward appearance and structure of national supervisory systems, and that national supervisors will anyway be the bedrock of the new Level 3 committee system being considered for banking, insurance and conglomerates;
11. Stresses that the need for adequate financial resources for the national supervisors is currently more important than the format of national financial architecture; underlines the fact that the resource issue is a strategic priority which would enable supervisors to carry out their tasks adequately; notes that a single financial market needs skilled regulatory and supervisory authorities in all the EU countries, in order to ensure a level playing field and avoid regulatory and supervisory arbitrage;
12. Calls on the Commission to present a report to the Council and Parliament on the lessons to be learned from the current crisis for regulation, supervision and banking oversight in Europe and, in order to do so, to hold public, transparent consultations with European banking associations, the ESCB, national banking supervisors, and trade union and consumer organisations;

Banking and insurance supervision geared to current challenges

13. Calls on national supervisors to aim at 'real-time supervision' of financial institutions while avoiding the temptation to interfere constantly with business in progress, which would hinder innovation and fuel moral hazard among top managers of the institutions subject to supervision;
14. Draws attention, more specifically, to the extent to which insurance companies have recently been confronted with a number of adverse factors, e.g. the slump in equities, more frequent corporate bond defaults and the rash of catastrophes all over the world; calls for the development of an amended supervisory and solvency regime that is more attuned to an insurer's true risk profile, and which is also capable of encouraging insurers to develop their own internal risk-monitoring models;
15. Considers that regulations where supervisors are given the opportunity to adapt themselves to a constantly changing environment may perform better, while static enforcement of detailed rules may run the risk of being dodged by astute market participants; notes, however, that shifts in the interpretation of rules should be properly coordinated at the European level to avoid breaching the level playing field between market participants;
16. Considers that checks of periodic forms, however detailed they are, may not be sufficient to gauge the soundness of a given financial institution; notes that such quantitative checks may be complemented by on-site inspections carried out by skilled and experienced personnel, especially if credit institutions develop their own internal rating systems for calculating their capital adequacy under the draft Basle II Accord;
17. Considers, in this connection, that placing full-time teams of independent resident supervisory examiners on site at the largest European banks and insurance companies and financial conglomerates may be able to foster understanding of the supervised institution's activities, enhance reactivity, promote mutual understanding and facilitate the early detection of organisational flaws;
18. Is of the opinion that increased disclosure to shareholders by financial institutions can constitute another line of defence against excessive exposure to risk and lower the risk of financial instability; welcomes the inclusion of such an approach in the draft Basle II Accord (third pillar); notes also that better corporate governance rules that promote independent and able board directors can contribute to the stability of financial institutions; considers that disclosures by supervisors about the national implementation of directives are desirable, in allowing transparent monitoring of the level playing field, and would increase financial stability;
19. Notes that executive compensation schemes in financial institutions may have contributed to a focus on risk and short-term profit; notes that the previous euphoria and recklessness on the financial markets have certainly been fuelled by aggressive bonus or stock option policies, not least in investment banking; considers this to be an element to be monitored as such in the pursuit of financial stability; urges the formation of more stability-oriented schemes; calls on the Commission and national supervisors to devise guidelines applicable to such compensation schemes in the financial sector;

20. Notes that hedge funds are booming; calls on the Commission and national supervisors, in close cooperation with the American authorities, to carry out a census of these unregulated funds; calls for renewed thinking about their impact on systemic stability in the light of the LTCM affair and the current turmoil in the financial markets; would be ready to examine proposals for regulation defining minimum prudential rules applicable to hedge funds, in particular rules governing leverage and short selling;
21. Notes that the current crisis highlights the part played by accounting practices and standards in the volatility of the financial markets; considers that some IAS accounting standards which the European Union is required to adopt maintain or amplify such defects and threaten to exacerbate banking instability; the IAS 39 standard, in particular, is far too systematic in applying the principle of 'fair value', i.e. of instant market valuation, even where there is no market and where financial instruments are held until maturity; calls, therefore, for the application of this standard to be suspended so that an in-depth, transparent re-examination of this issue can take place;

Towards more consumer-friendly supervision of securities and financial markets

22. Notes that not all national supervisors allocate sufficient resources to enforcement tasks; regrets that one year after the terrorist attacks of 11 September, the CESR has not yet released a follow-up to its preliminary report delivered to the Ecofin Council in October 2001 as regards possible insider trading activity connected with the attacks;
23. Deplores the lack of expertise on financial market issues prevailing in the judiciary; calls on national financial supervisors to liaise more extensively with judicial authorities to make them more aware of the latest advances in financial market techniques; deplores the substantial procedural delays encountered by financial services consumers, especially in the treatment of cross-border complaints; calls on the Member States to set up specialised units of judges and prosecutors dedicated to the timely and efficient resolution of financial cases; welcomes any effort to facilitate out-of-court settlement by alternative dispute resolution mechanisms, such as the Fin-Net network set up by the Commission;
24. Takes the view that consultation of all interested parties is very important for the development of proper, appropriate legislation and calls on the Commission together with the European Parliament to develop a formal dialogue with representatives of associations representing both the financial and consumer sectors, including small shareholders associations, and with social partners;
25. Calls on national securities supervisors to develop 'financial literacy programmes' among the public to make it more aware of scams or mis-selling of financial products; calls on them to develop specific programmes aimed at vulnerable population groups;

International cooperation between prudential regulators and supervisors: some practical steps

26. Deplores the fact that the fight against various forms of white-collar crime – money laundering, tax evasion, market abuse, financing of terrorist groups – has long been involuntarily hindered by the reluctance of national authorities – including American ones – to cooperate with each other; points out that formal adherence to international standards –for instance the 40 recommendations of the Financial Action Task Force on

Money Laundering (FATF) – is not enough; stresses that effective enforcement figures should become the main yardstick for assessing whether a country should be put on a blacklist or not; welcomes the fresh resolve, after 11 September, to tackle these issues on a multilateral basis;

27. Emphasises that mutual trust is the most important prerequisite for effective cooperation between supervisors; expresses, in this connection, its strong opposition to allowing institutions subject to supervision to choose the supervisor which suits them best, as this would lead to a regulatory and supervisory race to the bottom, while competing supervisors would naturally tend to hide information from each other, a far cry from what is required;
28. Calls on national supervisors to set up a European supervisory training centre to share their experience, broaden their skills and facilitate the convergence of supervisory practices;
29. Calls on national supervisors to develop an active policy of exchanging personnel with each other; recommends that this secondment policy be extended to the United States and to any country which hosts major financial markets;
30. Calls on national supervisors to recruit personnel from other EU Member States, on a permanent or temporary basis, to ease cross-border communication and promote mutual understanding of distinctive national characteristics; proposes a target of 5% for non-secretarial staff, to be reached by the end of the decade;
31. Calls on national supervisors to set up a common database which would bring together the main prudential ratios for European financial institutions and would be accessible to every accredited European supervisor and available to the public at large; welcomes the work already done in the Banking Supervision Committee working group on credit registers and calls for the establishment of a pan-European large exposure register by linking up national credit registers;
32. Recommends that macro-prudential policies be given more prominence and calls for micro- and macro-prudential policies to be more closely linked; advises national supervisors to pool resources to set up a country/sector monitoring unit which would be able, if need be, to issue cautionary notices to the banking and insurance sectors warning against any excessive exposure to the fragile countries/sectors identified;
33. Calls on national supervisors to pool financial and human resources to establish 'forward posts' in the major non-EU economies and emerging markets in order to obtain first-hand information about the operations of subsidiaries of European banks and insurance companies abroad and supply up-to-date information to the common agency responsible for macro-prudential analysis;
34. Considers that the state of the financial sector in many candidate countries remains shaky, and that their financial markets are still nascent; calls on the Commission, the European Investment Bank and the European Bank for Reconstruction and Development to step up their efforts to promote sound banking principles; wishes to see adequate, coordinated training policies set up for the personnel of regulatory and supervisory bodies in the candidate countries;

35. Calls on the Commission and the various European supervision committees, together with the US Federal Reserve System and the Securities and Exchange Commission, to organise an annual transatlantic financial forum where current financial issues could be addressed in public; calls for dialogue to be stepped up, so as to deal with any bone of contention which may arise;

For a more active European Commission and for enhanced parliamentary oversight in banking and financial regulation and supervision

36. Calls on the Commission to reaffirm its leading role in framing legislation relating to securities; insists on core provisions to be decided at level 1; hopes that the increased reliance on committee work in the Lamfalussy framework is not an indirect way of escaping its responsibilities by 'subcontracting' its legislative tasks to level 3 committees; urges the Commission to strengthen its level of expertise by allocating more resources to the financial services area; hopes that the planned extension of the Lamfalussy framework will lead to coherent implementation and enforcement of prudential legislation within the European Union;
37. Wishes the Commission to make a systematic regulatory impact assessment of its draft legislation, which should include a full cost/benefit analysis without which no legislation should be brought forward; urges the European Parliament to carry out a similar cost impact assessment on any amendments it proposes to adopt; notes that systematic consultation with market participants may bring valuable insights in the preparatory stages of lawmaking;
38. Calls on the Commission to analyse the functioning of national supervisors; calls for an annual public scoreboard to be drawn up showing the performance of supervisors on a standardised basis;
39. Calls on the Commission to assess the extent to which cross-border consolidation in the financial markets is being restricted or promoted by national authorities; calls on the Commission to produce an annual 'scoreboard' showing the number of domestic/cross-border mergers and domestic/inward investment new ventures in the financial markets on a Member State by Member State basis; also calls on the Commission to study the interplay between competition policy and prudential policies in detail; wishes the opening up of national financial boundaries to lead to fair competition for the benefit of consumers; calls on the Commission to step up its fight against national cartels in the financial sector; calls on the Commission to assess the consequences for competition of the existence of only a few players in the auditing and financial rating sector;
40. Calls on the Commission and national supervisors to act, through appropriate regulation, by implementing the Commission Recommendation of 16 May 2002 (Statutory Auditors' Independence in the EU: A Set of Fundamental Principles (2002/590/EC)) to prevent conflicts of interest; is of the opinion that auditors and rating agencies should not seek alternative sources of income which generate obvious conflicts of interest;

Enhancing structural cooperation and coordination at European level

41. Endorses the emphasis on convergence not only in rules but also in implementation and supervisory practices, welcomes the institutionalisation of a regular dialogue between

supervisors at European level through the creation of the CESR that was decided recently in the field of securities supervision; recommends this approach for the banking and the insurance/ pension funds sectors, as well;

42. Considers that the interaction of regulatory and supervisory activity is an important element of this scheme, and recommends that in the banking and insurance/pension funds sector existing structures be used in order to avoid confusion and a proliferation of competing committees;
43. Endorses the role of the Commission as an independent and fair power-broker; points out that it is mandatory for the Commission to chair advisory committees, so as to fulfil Treaty obligations; would consider it natural for the Commission to run the secretariat of 'level 2' committee committees;
44. Would support the establishment of an EU-wide forum of financial authorities at the highest level, with the participation of the ESCB and the ECB, the latter of which should be responsible for upstream analysis and warnings, in order to deal with changes in systematic weaknesses and risks; this could set footbridges between banking, insurance and securities supervision, particularly as regards macro-prudential supervision;
45. Calls on the Commission, given the experiences in the United States, to draw up a report on the effects on the stability and integrity of the financial services sector of the fact that there is insufficient competition both between auditing firms which audit major EU companies and between rating agencies;

Towards integrated European supervision in the future

46. Considers that, at the present stage, enhanced cooperation and coordination of national supervisors is appropriate and necessary; notes that the current stage is a transition in a trend which will ultimately lead to the creation of one or several European integrated supervisors, while ensuring that small domestic-based financial institutions will still be supervised at national level to maintain proximity between supervisors and the supervised entities;
47. Considers that it is speculative at present to determine at this stage what the optimum structure of financial supervision in the EU would be in the future, given the largely unpredictable changes in the financial industry, and the fact that no prospective scheme (national integrated supervisors, national sector-based supervisors, single European agency, sector-based European supervisors, ESCB) has currently a decisive edge over others;
48. Urges Ministers of Finance to avoid premature decisions and to organise a comprehensive public debate with all the relevant players about integrated European supervision, focusing on examining the feasibility of European supervision of large financial institutions with cross-border and cross-sector operations;
49. Calls for a revision of the Treaty that would make it possible – if it were so decided in the future – to provide for a legal base for prudential supervision of large pan-European financial entities at European level, either by modifying Article 105(6) to enable the ECB

to act as a direct supervisor or by inserting a new chapter in the Treaty that would allow for the creation of a European financial services supervisory agency or European sectoral agencies for banking, insurance/pension funds and/or financial conglomerates;

50. Notes that the European Central Bank does not currently have the teams or the mandate to supervise directly European financial institutions; calls on it to focus on payment systems for the time being, where there is still much to do, especially as regards the development of safe, fair and efficient financial infrastructures in Europe; notes also that the European Central Bank has a significant role to play in macro-prudential analysis and crisis management as part of its mandate to safeguard financial stability; considers it to be evident that the ECB should be properly involved in the various forms of future EU-wide prudential supervision;

Addendum on the EFC report

51. Notes that the Economic and Finance Committee (EFC) report of 3 October proposes the extension of the Lamfalussy procedure to the regulation and supervision of banking, insurance/pension funds and financial conglomerates; welcomes the decision of the ECOFIN Council to launch a broad debate, including wide consultation of market participants;
52. Notes that the case for urgency is still to be made for the extension of the Lamfalussy temporary arrangement to more than regulation for a single European securities market; recalls the role of the Interinstitutional Monitoring Group, set up in October 2002, to assess progress in implementing the Lamfalussy process and to advise the Council and Parliament; notes that its first report will be made public only in Spring 2003;
53. Criticises the Commission and the Council for not having submitted proposals in connection with the Convention, as agreed, on revising the Treaty with regard to secondary legislation in Article 202 and the European Parliament's right of call-back;
54. Highlights a number of positive points in the EFC report that are in line with the EP's recommendations in this report, e.g. acknowledgement of the role of the central banks, whether they have supervisory tasks or not; the wisdom of using existing structures for coordination, and the willingness to combine regulation and supervision at European level and therefore to reinforce coordination at this level;
55. Endorses the need for a high-level cross-sectoral policy platform, but regrets that the chair of the Financial Services Policy Group (FSPG) has been transferred from the Commission to a Member State; would also find it natural that a representative of the European Parliament attend meetings of such a group, whose main task is supposedly to provide 'political advice and oversight';
56. Expresses its concern about attempts by the EFC to control the functioning of the whole Lamfalussy procedure by having a strong grip on the FSPG; recommends that this new high-level committee report directly to the Council, the Commission and Parliament and serve as a forum to assess financial stability and discuss medium- and long-term issues, whereas allowing it to be involved in level 2 micro-management might threaten the role of the Commission;

57. Recalls that the European Parliament is not only to be consulted but that Parliament is co-legislator together with the Council;
58. States that prior to any extension of the Lamfalussy procedure, fulfilment of the following conditions is required:
- first, stresses that the most important consideration in the extension of the Lamfalussy temporary arrangements for implementing legislation is evidence that the Convention, the Commission and the Member States are considering a permanent solution to the institutional imbalance and lack of parliamentary oversight in Article 202 of the Treaty establishing the European Communities, so as to provide Parliament with a call-back procedure to ensure that the original remit of legislation is respected and that open and consultative procedures are followed;
 - secondly, such an extension shall fully abide by the rules and commitments expressed in the solemn declaration delivered in plenary session on 4 February 2002 by the President of the European Commission and in the letter of 2 October 2001 addressed by the Internal Market Commissioner to the Chair of the Committee on Economic and Monetary Affairs with regard to safeguarding the European Parliament's role in this process;
59. Stresses that any legislative work, notably at level 2 and level 3 of the Lamfalussy process, should be as transparent as possible and must offer citizens the opportunity of involvement at all stages; thus calls for explicit rules on procedure, transparency and consultation to give explicit guarantees for equal involvement of all citizens and interested parties during all phases of levels 2 and 3 of the Lamfalussy process;
60. Recalls that in its White Paper on European Governance the Commission stated that Article 202 of the EC Treaty had been rendered obsolete by the codecision procedure; deplores the lack of initiative from the Commission to come up with a proposal for concrete Treaty change for the Convention and urges it to do so; likewise encourages its own delegation to the Convention to do the same;
61. Stresses that the commitment to prepare for such a Treaty change and the implementation of the commitments referred to in point 58 above should be expressed by the Member States in a declaration at the Copenhagen Summit in order to reach a common position and pave the way for successful implementation of the agreed principles;
62. Underlines that Parliament, in those circumstances, would welcome the extension of the Lamfalussy procedure;
63. Instructs its President to forward this resolution to the Council and Commission.

EXPLANATORY STATEMENT

The whole financial system is weathering a crisis of unprecedented size. Certainly, economists may point out that the US downturn was bound to result in a number of bankruptcies. That is the lot of every cyclical downturn. But dramatic failures such as Enron or WorldCom have revealed how the financial system distorts the way economic agents behave. Far from smoothing out the bumps in the real economy, the financial system has fuelled the high-tech bubble, by adding an unhealthy dose of conflicts of interest within all the major players of the system.

Against this background, how do we feel in Europe? As usual, public authorities have felt compelled to reassure the public by playing down the consequences of a major crisis. The European Commission has told us that our accounting system is better than the US GAAP and that such a disaster is unlikely in Europe. The reality may be less rosy. The magnitude of the crisis has been less damaging simply because the high-tech sector's share of the market was smaller in Europe. But, in practice, there are several reasons for arguing that Europe should not be complacent. Because risk has significantly increased over the past ten years, for all market participants an extra impetus to strong and effective prudential supervision is imperative.

The resolution

In this report, your rapporteur has tried to adopt a pragmatic stance. The aim is to propose a number of reasonable and practical steps that may improve the supervision of financial entities. A complete overhaul of the regulatory and institutional framework might give rise to institutional battles and bring more confusion instead of improving the quality of supervision. Rather your rapporteur prefers a step-by-step approach both at the national and at the European level that joins all forces to improve implementation.

On the national level, the pros and cons of a single supervisor for the entire financial sector have been assessed. It appears that evidence is mixed. A single supervisor at the national level may look attractive from an organisational point of view. However, it also makes sense to have separated supervisors for banking, insurance/pension funds and securities. To your rapporteur's point of view, what matters more are funding and cooperation. Funding is an important issue. European supervisors often lack the proper means for fulfilling their tasks adequately.

As regards cooperation between supervisory authorities, it shall be improved along two dimensions:

- cooperation within each country, for instance between the banking supervisor and the insurance supervisor.
- cooperation between supervisors of different countries.

In this report concrete and sensible measures are suggested such as:

- a common training centre for supervisors;
- an ambitious policy of exchange of personnel;

- 'common financial embassies' in foreign countries to monitor country risk and the activities of EU financial institutions abroad.

Risks have increased. The insurance sector is especially fragile. Life insurance has been hit by the fall in stock markets. Risk insurance has been hit by the consequences of 11 September. Taken together, these two factors put at risk the entire insurance sector, which should be closely watched in the coming months.

Concerning the ways to supervise, your rapporteur is strongly in favour of a principle-based supervision. Quality of supervision is more important than quantity of rules. What we want is skilled supervisors. We want supervisors that understand what is happening on financial markets. We want supervisors that are able to go beyond a formal analysis to track the hidden weaknesses in the balance sheets of supervised entities. Your rapporteur puts forward several solutions. For instance, inserting resident supervisors into the largest banks and insurance companies may be a good idea to foster mutual understanding and detect structural flaws. Of course their independence should be safeguarded.

There is a clear link with the issue of corporate governance. The report mentions several issues that require quick policy answers, for instance executive compensation schemes in the financial sector, and the risks of hedge funds.

Your rapporteur thinks also that consumers should be at the centre of policies conducted by financial supervisors:

- knowledge of consumers should be improved;
- they should have the right to express their opinion in consultation exercises;
- they should have the effective capability to defend their rights in court.

Institutional arrangements at the European level are a sensitive subject. The Council wants to make reforms in this area. Your rapporteur would like to see if it is possible for the Economic and Monetary Affairs Committee to agree on a few principles.

First, we need a strong Commission. The Commission has been involved for many years in the construction of a unified financial market. We would like to stress that the Commission is an independent referee. And the Commission has the capability to bring together providers and consumers of financial services. As it is said in the draft, the Commission is a fair power broker.

Second, we must also be sure that committee powers are not abused. The Parliament will monitor closely CESR (Committee of European Security Regulators). If committee performs fairly, it will be possible to have an open approach on extending the Lamfalussy procedure. But it would be better first to assess the functioning of the existing Lamfalussy arrangements.

Finally, your rapporteur tries to imagine the future of prudential supervision. This cannot be more than an attempt because the industry may change so quickly that it is difficult to make reliable forecasts. However, your rapporteur bets that in a decade a European supervisor will emerge. How exactly will be shaped should not our main focus though at the moment; much more important is that the patchwork of regulatory and supervisory structures that exist

presently in the EU as well as the Central Banks will be involved in this integration process and will focus on practical cooperation and improvement of effectiveness, instead of fighting institutional battles.

For the time being, your rapporteur proposes a wide and open debate on this matter. Not only debate however, also practical steps are necessary and conceivable. For instance, a discussion would be interesting to assess the effectiveness of a two-tier system of supervision. The largest financial institutions would be supervised at the European level whereas the local institutions could still be supervised at the local level. This system would have some similarities with the American system. Today's thinking will bear fruit in tomorrow's integrated European supervisor.

Recent institutional arrangements

The informal Ecofin meeting in Oviedo on 13 April 2002 agreed on the need to ensure that the EU has appropriate structures in place for financial regulation and supervision in a rapidly changing financial environment. On 7 May 2002 the Ecofin Council invited the Economic and Financial Committee (EFC) to assess and report on possible arrangements for financial regulation and supervision. A preliminary report assessing possible options was presented to the Ecofin Council meeting in July 2002, and a final report will have been completed by the end of the year. Central to the debate is the extension of the Lamfalussy arrangements to the banking and the insurance sector.

The rapporteur feels that hasty conclusion of this debate may bring more confusion than clarity, for three reasons:

- First, we do not know how well the Lamfalussy procedure works in practice. As of September 2002, there is not a single adopted directive under the Lamfalussy procedure. Extending successful procedures is sound management. Extending untried prototypes is running a rather large risk. That is why respected figures, including Mr Lamfalussy himself, have warned against a botched reform. We know that the compromise reached between the Commission, Council and Parliament is fragile at this stage. It is especially feared that Level 3 committees will create and pursue their own agenda and work largely without further recourse to Level 1 and Level 2;
- Second, the rapporteur fears that a hidden agenda behind these plans aims to re-nationalise financial services regulation by giving a too prominent role to national supervisors and ministers of finance. Unfortunately, their track record in the construction of a single financial market has been less than satisfactory. We need only to recall the inertia that surrounded cross-border retail payments for years, until the Commission took the offensive. Endless bickering would not only constantly impede such a nationally-tainted decision-making process. It would also signal the relentless supremacy of the three or four national regulators with a large financial market on their own territory;
- Third, regulators and supervisors must be 'accountable'. Financial regulation (for instance on prospectuses and market abuse) and the rules applied by financial supervisors (for instance on solvency and capital adequacy) are adopted under the codecision procedure. The procedure does meet high democratic standards, by allowing all the actors in the financial debate to express their views freely in an open forum when a legislative proposal

is put to Parliament. The rapporteur wants to stress that it is the European Parliament that ensures truly democratic accountability. We have tirelessly pleaded for a more democratic Lamfalussy procedure. To put it bluntly, identifying national procedures with accountability would be a step backward in the construction of Europe.

That is why the European Parliament must remain vigilant: forewarned is forearmed.

The future of supervision : from fragmentation to unification			
Cross-Sector (national models)	<i>1. Sectoral</i> (separation between banking, insurance/pension funds and securities)	<i>2. Cross-sector: functional</i> (separation between prudential supervision and conduct-of-business)	<i>3. Cross-sector : integrated</i> (all sectors, all practices)
Cross-border (European models)			
A. Fragmented with cooperation	Cooperation in sectoral committees	Cooperation in functional committees	Cooperation national single agencies
B. Coordination (or enhanced cooperation)	Coordination between national sectoral supervisors (harmonisation in sectoral regulation and convergence in supervisory practices in banking, insurance/pension funds and securities respectively)	Coordination between national functional supervisors (functional EU-wide legislation and convergence in supervisory practices in prudential supervision and conduct of business supervision)	Coordination between national single agencies (tendency toward single financial services market act within the EU, convergence in supervisory practices between national single agencies)
C. Two-Tier	Separate European banking and insurance/pension funds supervisors for large institutions & national supervisors for local entities Coordination between the two level of supervision + European Financial Market Agency	European prudential supervisor for large internationally operating institutions (NB financial conglomerates) & national prudential supervisors for local entities Coordination between the two level of supervision + European Financial Market Agency	European single agency for large institutions and financial markets & national single agencies for local entities Coordination between the two level of supervision
D. Unified	Separate European banking, securities and insurance supervisors	European prudential supervisor + European Financial Market Agency	European Single Agency