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## REPORT

with recommendations to the Commission on Lamfalussy follow-up: future structure of supervision  
(2008/2148(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Ieke van den Burg and Daniel Dăianu

(Initiative – Rule 39 of the Rules of Procedure)

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## MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

**with recommendations to the Commission on Lamfalussy follow-up: future structure of supervision  
(2008/2148(INI))**

*The European Parliament,*

- having regard to the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies<sup>1</sup>,
- having regard to the Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54(3)(g) of the Treaty on consolidated accounts<sup>2</sup>,
- having regard to Council Directive 86/635/EEC of 8 December 1986 on the annual accounts and consolidated accounts of banks and other financial institutions<sup>3</sup>,
- having regard to Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings<sup>4</sup>,
- having regard to Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes<sup>5</sup>,
- having regard to Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions<sup>6</sup>,
- having regard to Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate<sup>7</sup>,
- having regard to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments<sup>8</sup>,
- having regard to Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market<sup>9</sup>,
- having regard to Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions

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<sup>1</sup> OJ L 222, 14.8.1978, p. 11.

<sup>2</sup> OJ L 193, 18.7.1983, p. 1.

<sup>3</sup> OJ L 372, 31.12.1986, p. 1.

<sup>4</sup> OJ L 374, 31.12.1991, p. 7.

<sup>5</sup> OJ L 135, 31.5.1994, p. 5.

<sup>6</sup> OJ L 125, 5.5.2001, p. 15.

<sup>7</sup> OJ L 35, 11.2.2003, p. 1.

<sup>8</sup> OJ L 145, 30.4.2004, p. 1.

<sup>9</sup> OJ L 390, 31.12.2004, p. 38.

(recast)<sup>1</sup> ,

- having regard to Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast)<sup>2</sup> ,
  - having regard to the amended Commission proposal for a directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) (COM(2008)0119),
  - having regard to the Commission Communication of 27 September 2004 on Preventing and Combating Corporate and Financial Malpractice (COM(2004)0611),
  - having regard to the Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies<sup>3</sup>,
  - having regard to its resolutions of 11 July 2007 on financial services policy (2005–2010) - White Paper<sup>4</sup> ), of 4 July 2006 on consolidation of financial services industry<sup>5</sup>, of 28 April 2005 on the current state of integration of EU financial markets<sup>6</sup> and of 21 November 2002 on prudential supervision rules in the European Union<sup>7</sup>,
  - having regard to the Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience of 7 April 2008,
  - having regard to the Council conclusions on the EU supervisory framework and financial stability arrangements, adopted on 14 May 2008, and Council conclusions on related issues following its meetings of 3 June 2008, 4 December 2007 and 9 October 2007,–  
having regard to Article 192, second paragraph, of the EC Treaty,
  - having regard to Rules 39 and 45 of its Rules of Procedure,
  - having regard to the report of the Committee on Economic and Monetary Affairs (A6-0359/2008),
- A. whereas there is an ongoing review of Directives 2006/48/EC and 2006/49/EC and an expected proposal on Credit Rating Agencies,
- B. whereas the Commission has not addressed a series of requests from Parliament, including those made in its above-mentioned resolutions and whereas a list of recommendations as to how the functioning of financial markets supervision might be improved is set out in the Annex,
- C. whereas financial supervision has not kept pace with market integration and the global evolution of financial markets demanding an update of the existing regulation and

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<sup>1</sup> OJ L 177, 30.6.2006, p. 1.

<sup>2</sup> OJ L 177, 30.6.2006, p. 201.

<sup>3</sup> OJ L 358, 29.12.2004, p. 55.

<sup>4</sup> OJ C 175E, 10.7.2008, p. 392.

<sup>5</sup> OJ C 303E, 13.12.2006, p. 110.

<sup>6</sup> OJ C 45E, 23.2.2006, p. 140.

<sup>7</sup> OJ C 25 E, 29.1.2004, p. 394.

supervision systems in order to tackle systemic risks better, provide financial stability, attain the objectives of the European Union and contribute to an improved global financial governance,

- D. whereas any suggestion made by Parliament for legislation should be principle based and the recommendations set out in the Annex should be developed in consultation with the supervisory authorities, financial markets participants and other relevant bodies,
- E. whereas there is a growing number of pan-European entities, whose activities span several countries; whereas the interlocking of many national authorities has increased complexity and blurred the lines of responsibility, especially for macro-prudential supervision and crisis management,
- F. whereas the current financial crisis, which was triggered by US subprime mortgages and derived products, has spread worldwide due to the increasingly integrated nature of markets, reinforcing the indication that existing financial market regulation and supervision is not sufficiently convergent at either EU or international level; whereas a reform of financial market regulation and supervision is therefore welcome,
- G. whereas the crisis has led to a credit squeeze entailing a higher price of credit for many market players; whereas economic growth and employment are impaired by the current turmoil on the financial markets,
- H. whereas capital markets intermediation and new kinds of financial vehicles did bring about benefits, but have also given rise to new sources of systemic risk globally,
- I. whereas the "originate-to-distribute" model has enhanced competition and spread risk, but has also weakened incentives to evaluate and monitor risk and has led to a breakdown in due diligence in some cases,
- J. whereas improper practices such as inadequate risk management, irresponsible lending, excessive debt (leverage), weak due diligence and sudden withdrawal of liquidity pose significant risks to financial institutions and may threaten financial stability,
- K. whereas innovative techniques, which were designed to diminish risk at the micro level, and were in themselves compliant with current regulation, could lead to risk concentration and systemic risk,
- L. whereas harmful regulatory arbitrage should be prevented,
- M. whereas adequate levels of transparency towards the public, investors and supervisory authorities must be ensured,
- N. whereas compensation schemes which reflect individual and corporate performance should not reward excessive risk-taking for short-term, at the expense of necessary long-term, performance and prudence,
- O. whereas conflicts of interest, which may arise from the business model used by financial institutions, credit rating agencies, and audit and law firms, must be addressed and

monitored,

- P. whereas failures by credit rating agencies in respect of complex structured products and misconceptions of the meaning of ratings by market participants have generated substantial negative externalities and market uncertainties; whereas credit rating agencies' procedures need reviewing,
- Q. whereas self-regulatory solutions, proposed by the credit rating agencies are as yet untested and probably insufficient to meet the pivotal role they play in the financial system,
- R. whereas market integration, while generally beneficial, should be accompanied by an appropriately integrated approach to supervision, which also avoids unnecessary red tape and is consistent with better regulation policies,
- S. whereas the Commission should carry out a comprehensive impact assessment of a legislative proposal,
- T. whereas the European Union needs more consistent and effective, properly implemented, but not overly burdensome, regulation and supervision in order to mitigate the risk of future financial crises and ensure a level playing field across borders and among all market participants; whereas the European Union should play a leading international role as well as reinforce consistent implementation and convergence of its own regulation and supervision,
- U. whereas a comprehensive review of current EU regulatory and supervisory arrangements is necessary together with measures to improve global supervisory cooperation covering the capital adequacy framework, transparency, and governance as key prerequisites for effective regulatory and supervisory arrangements in a coordinated manner,
- V. whereas the supervisory approach should be adapted to specificities of the business and aspects of it that are already regulated; whereas the objectives of financial market supervision and the prudential supervision of particular institutions vary,
- W. whereas future proposals should take account of negotiations on the Solvency II proposal and the review of Directives 2006/48/EC and 2006/49/EC,
- X. whereas supervisory cooperation needs to take into account the third-country dimension of supervision of international groups as most, if not all, major financial groups in the European Union have third-country interests,
- Y. whereas following the Council conclusions of 3 June 2008, 4 December 2007 and 9 October 2007, a major programme of work is already under way to make targeted improvements to the arrangements for EU supervisory cooperation; whereas extensive programmes of work are also under way in the European Union and worldwide with a view to understanding the causes of market turmoil and responding appropriately,
- Z. whereas a group of wise persons should be set up by autumn 2008, bringing together different stakeholders (supervisors, regulators, industry representatives, etc.) and

elaborating a longer term supervisory vision; whereas that group should be tasked with developing a blueprint and roadmap for a more radical long-term reform towards full institutional integration; whereas going beyond the architecture of financial supervision, the group could also address issues such as a single rulebook for financial supervision, a deposit guarantee scheme and a common insolvency regime, which are commensurate with an integrated financial and supervisory system,

1. Requests the Commission to submit to Parliament by 30 November 2008, on the basis of Article 44, Article 47(2), Article 55, Article 95, Article 105(6), Article 202, Article 211 or Article 308 of the EC Treaty, a legislative proposal or proposals covering the matters dealt with in the detailed recommendations below;
2. Confirms that the recommendations respect the principle of subsidiarity and the fundamental rights of citizens;
3. Considers that, where appropriate, the financial implications of the requested proposal or proposals should be covered by EU budgetary allocations;
4. Instructs its President to forward this resolution and the accompanying detailed recommendations to the Commission, the Council and the governments and parliaments of the Member States.

**ANNEX TO THE MOTION FOR A RESOLUTION:  
DETAILED RECOMMENDATIONS ON THE CONTENT  
OF THE PROPOSAL(S) REQUESTED**

**1. *Recommendation 1 - Basic prerequisites for effective regulatory and supervisory arrangements***

*The European Parliament considers that the legislative act(s) to be adopted should aim to regulate:*

**1.1. Measures to improve the EU financial services regulatory framework:**

Capital adequacy framework, in particular:

- (a) revise capital requirements rules by strengthening risk management, liquidity and exposure provisions in a consistent and, where appropriate, counter-cyclical manner for entities operating on financial markets, and ensure appropriate capital requirements for all entities operating on financial markets while taking into account systemic risk;
- (b) enhance the resilience of the capital adequacy framework to be able to deal with financial market disruption, whilst respecting the responsibilities of national authorities;
- (c) ensure that the rules are counter-cyclical as far as possible;
- (d) reform the framework to improve risk management; ensure adequacy of mathematical models, and, as appropriate, expand the range of scenarios and frequency of stress testing;
- (e) ensure appropriate capital requirements for complex financial products and derivatives;
- (f) ensure disclosure of off-balance-sheet items, structured investment vehicles (SIVs) and any liquidity assistance facility, and require proper assessment of the risks that they pose, so that market participants are aware of their existence and of how they operate.

**1.2. Measures to improve transparency:**

- (a) Securitisation: foster transparency, clarity and the provision of data on complex financial products and the securitisation process, taking into account industry-led initiatives in this area; ensure that the securitisation and credit rating process does not result in an unjustified increase in the total value of the securitised product beyond the value of the underlying assets,
- (b) Complex Financial Products (CFS): ensure that credit rating agencies use consistent and appropriate rating terminology that clarifies how such products differ among themselves especially in terms of volatility, complexity and vulnerability to market stress, while taking account of the need for investors to develop procedures to assess the quality of structured products without relying solely on ratings;

- (c) Accounting rules, valuation and pricing:
  - (i) ensure an appropriate accounting treatment of material securitisation vehicles, so that companies and financial institutions cannot artificially keep material special purpose vehicles or SIVs, etc. off their balance sheets;
  - (ii) ensure that the rules on valuation and pricing standards for complex financial products are appropriate, in particular in the context of IAS 39, to be elaborated in cooperation with the IASB and other competent international bodies.
- (d) Unregulated markets: increase transparency of over-the-counter (OTC) markets with regard to their liquidity, address major sources of systemic risk (i.e. counterparty concentration risk), and, where appropriate, encourage market participants to clear OTC trades in clearing houses.

### **1.3. Governance measures:**

- (a) Securitisation: Require originators to assess and monitor risk and ensure transparency of the debt or mortgage backed securities in order to allow investors to perform adequate due diligence.
- (b) Remuneration schemes: ensure financial institutions disclose their remuneration policy, in particular the remuneration and compensation packages of directors; ensure that all transactions involving management can be clearly identified in the financial statements; ensure prudential supervisors include in their assessment of risk management the influence of remuneration, bonus schemes and taxation to ensure that they contain balanced incentives and do not encourage extreme risk taking.
- (c) Corporate liability regime: ensure that liability regimes providing for appropriate fines and other penalties for failure to comply with financial services legislation are established, allowing executives in financial institutions to be suspended or disqualified from working in all or relevant parts of the financial sector in the event of a breach of duty or wrongful trading;
- (d) Credit rating agencies: measures addressing e.g. conflicts of interests, quality assurance systems and oversight in a manner consistent with the considered recommendations of the Financial Stability Forum, the International Organisation of Securities Commissions, the Committee of European Securities Regulators and the European Securities Markets Expert Group relating to potential enhancement of credit rating processes, drawing lessons where appropriate from the oversight of auditors; give particular consideration to: transparency on rating methodologies, assumptions and stress tests; for supervisors to be able to call for an 'audit trail' of the originator/credit rating agency correspondence and to be notified in the event of significant concerns over models; ensure that credit rating agencies provide enhanced information as to the particular characteristics of complex debt products, mortgage related products and traditional debt, and that the

rating agencies apply differentiated symbols for the rating of complex debt products, mortgage related products and traditional debt; foster transparency of credit rating agencies, provide enhanced transparency as to the methodology and criteria relevant to particular ratings of complex debt products, mortgage related products and traditional debt.

## **2. *Recommendation 2 - Financial stability and systemic risk measures***

*The European Parliament considers that the legislative act(s) to be adopted should aim to regulate:*

- (a) Financial stability and systemic risks: establish databases, forward-looking scenarios, policies on macro prudential supervision and financial stability, as well as an early-warning system and ensure that the European Central Bank (ECB), the European System of Central Banks (ESCB) and the Banking Supervisory Committee of the ESCB (BSC) take an active role in their initiation, elaboration and operation; ensure that EU supervisors and central banks provide the ECB, via the BSC, with relevant non-public and confidential up-to-date aggregate micro-prudential information/data to allow it to fulfil this function and prevent systemic risk;
- (b) EU crisis prevention, management and resolution arrangements: In particular:
  - (i) enhancing crisis prevention and management arrangements at EU level, where necessary, including:
    - monitoring and assessing systemic financial risks at EU level;
    - setting up an EU early-warning system and early-intervention mechanism for dealing with weak and failing entities, when an EU cross-border financial group is concerned or when the EU financial stability is threatened; such a mechanism should be well-defined, clear, able to prompt action and comply with EU State aid rules;
    - facilitating the cross-border transfer of funds within a group in extreme situations by taking into account the interests of the creditors of the group's individual entities and having regard to Directive 2001/24/EC;
    - cross-border crisis management and clarify State aid rules in cases of cross-border crisis;
  - (ii) enhancing crisis resolution arrangements by improving the EU rules on winding up and setting up arrangements of burden sharing among relevant Member States in cases of insolvency within cross-border financial groups;
- (c) ensure that EU rules on deposit guarantees are sufficiently coordinated to guarantee a level playing field for financial institutions; EU rules on deposit guarantees should be amended to support further development of ex-ante schemes financed by contributions from financial institutions; the level of

refund should be significantly increased and the availability of refunds to retail clients in case of failing financial institution should be ensured within a reasonable timeframe including in cases of cross-border situations;

- (d) promote similar rules for insurance guarantees, whilst recognising the different nature of insurance and banking;
- (e) ensure market diversity and encourage institutions that have long-term funding or liabilities to diversify market and liquidity risks.

### **3. Recommendation 3 - Supervisory framework**

*The European Parliament considers that the legislative act(s) to be adopted should aim to regulate, streamline, integrate and complete the present supervisory system by means of the following:*

#### **3.1. Supervision of large cross-border financial groups:**

- (a) by the end of 2008, a regulation will require colleges of supervisors for the largest cross-border financial groups or holdings operating in the EU. The regulation should contain clear criteria for identifying the cross-border financial groups or holdings for which such colleges will be mandatory. In cases of substantial third-country involvement, separate parallel structures should be avoided, and third country supervisors could be invited to be involved as far as reasonable and practicable.
- (b) the colleges will be composed of representatives of the national supervisory authorities dealing with prudential supervision. The regulation should contain clear principles for the national supervisors that have to be represented in the mandatory colleges, taking into account the group's market size in a Member State, the volume of cross-border operations, the volume and value of assets to reflect the importance of the group activities, ensuring that all Member States in which the parent undertaking, subsidiaries and significant branches are operating will be represented, and also taking into account the need to involve third-country supervisors where reasonable and practicable. Special attention should be given to the challenges with which supervisors in rapidly catching up economies are faced. To achieve operational integration, the consolidating supervisor must have full process-leadership within the college, i.e. the consolidating supervisor must be the central point of contact for the financial group, ensuring appropriate delegation of tasks and responsibilities within the college.
- (c) the colleges will normally be chaired by the consolidating supervisor from the Member State where the central administration or the main EU office of the cross-border financial groups or holdings is established. The consolidating supervisor will host and primarily staff the secretariat.
- (d) ensure collection, exchange and access to relevant information amongst the members of the college and amongst all supervisors involved within the EU and stimulate arrangements for maximising exchange of information with third-country supervisors.

- (e) the colleges will decide, where appropriate, on the basis of a qualified majority voting (QMV) system based on principles and objectives that will ensure consistency, fair and appropriate treatment and a level playing field.

### **3.2. Configuration of EU supervision: Lamfalussy Level 3 Committees:**

- (a) by the end of 2008 a regulation will strengthen and clarify the status and accountability of the Lamfalussy Level 3 Committees, giving the Level 3 Committees legal status commensurate with their duties, and coordinate and streamline the action of the different sector supervisory authorities, reinforce their tasks and ensure appropriate staffing and resources.
- (b) in addition to the advisory tasks, the Lamfalussy Level 3 Committees will be given the task (and the tools and resources) to ensure and actively promote supervisory convergence and a level playing field in the implementation and enforcement of EU legislation. National supervisors should be committed to the execution of the tasks and decisions of the Lamfalussy Level 3 Committees. This should be included in the mandates of the national supervisors and their mandates must be brought better in line with each other.
- (c) the Lamfalussy Level 3 Committees should present an annual work plan. Parliament, the Council and the Commission should approve the Committees' annual work plans and reports.
- (d) the Lamfalussy Level 3 Committees will be able to take decisions on the basis of a fair and appropriate QMV system; such a procedure should be elaborated both for decisions on supervisory convergence issues and for the advice to the Commission on legislation and regulation.
- (e) the Lamfalussy Level 3 Committees should:
  - (i) develop procedures for data provision in cross-border situations;
  - (ii) issue recommendations on specific (macro) supervisory practice issues;
  - (iii) issue guidelines to ensure coherence and streamline the supervisory practices of the colleges;
  - (iv) develop procedures to mediate conflicts that may arise between members of a college;
  - (v) design common reporting standards and data provision requirements for groups, preferably in a multi purpose format such as Extensible Business Reporting Language (XBRL);
  - (vi) represent the EU in international sector bodies of supervisors such as the International Organisation of Securities Commissions;
  - (vii) establish a periodical panel review process for each of the colleges to ensure convergence on college processes. The review panel should be set up as a joint group of the Lamfalussy Level 3 Committees and the BSC, the latter bringing in the macro-prudential perspective which is

crucial to ensure close cooperation between supervisors and central banks and to effectively manage crisis situations.

- (f) the chairs of the Lamfalussy Level 3 Committees should meet on a regular basis to reinforce cross-sector cooperation and coherence between the three Lamfalussy Level 3 Committees.
- (g) together they should:
  - (i) coordinate between the Lamfalussy Level 3 Committees ;
  - (ii) provide for common data and statistics;
  - (iii) cooperate with the BSC and the ECB for the purpose of coordinating financial stability issues;
  - (iv) where necessary, establish appropriate arrangements for dealing with conflicts that may arise between the national and/or sectoral supervisors that participate in colleges, or between the Lamfalussy Level 3 Committees;
  - (v) promote a European supervisory culture for the future that is solid and sustainable and provides for a better cross-sector and cross-border integration and coordination.
- (h) elaborate a supervisory architecture that is solid and sustainable and which provides for a better cross-sector and cross-border integration and coordination.

### **3.3. EU financial stability arrangements:**

- (a) by the end of 2008, a proposal will require arrangements for financial stability oversight at EU level. Those arrangements should ensure the efficient collection and analysis of micro and macro prudential information for the early identification of potential risks to financial stability, integrated with global work on financial stability. Those arrangements should enable EU supervisors and central banks to react promptly and develop a rapid reaction force for crisis situations with a systemic impact for the European Union.
- (b) the oversight arrangements should, most importantly, aim to strengthen horizontal links between macro-economic and financial market supervision. Strengthening the ECB's role in this respect is necessary. Procedures for cooperation and information-sharing between the Lamfalussy Level 3 Committees and ESCB/BSC should be developed.
- (c) specific issues to be addressed should include:
  - (i) establishing a proper system of supervisory data collection and exchange;
  - (ii) analysing and elaborate those data;
  - (iii) developing procedures for the provision and collection of confidential data;

- (iv) providing early-warning signals about dynamics that can endanger the stability of the financial system;
- (v) mechanisms for rapid reaction force in case of a threat to financial stability;
- (vi) representing the European Union in international bodies of supervisors such as the Financial Stability Forum and identify an EU counterpart for supervisors in other parts of the world.

## RESULT OF FINAL VOTE IN COMMITTEE

<b>Date adopted</b>	10.9.2008
<b>Result of final vote</b>	+: 26 -: 1 0: 14
<b>Members present for the final vote</b>	Mariela Velichkova Baeva, Pervenche Berès, Sebastian Valentin Bodu, Sharon Bowles, Udo Bullmann, David Casa, Christian Ehler, Elisa Ferreira, José Manuel García-Margallo y Marfil, Jean-Paul Gauzès, Benoît Hamon, Gunnar Hökmark, Karsten Friedrich Hoppenstedt, Sophia in 't Veld, Othmar Karas, Christoph Konrad, Guntars Krasts, Kurt Joachim Lauk, Andrea Losco, Astrid Lulling, Gay Mitchell, Joseph Muscat, John Purvis, Bernhard Rapkay, Dariusz Rosati, Eoin Ryan, Antolín Sánchez Presedo, Margarita Starkevičiūtė, Ivo Strejček, Ieke van den Burg, Cornelis Visser, Sahra Wagenknecht
<b>Substitute(s) present for the final vote</b>	Daniel Dăianu, Harald Ettl, Ján Hudacký, Piia-Noora Kauppi, Baroness Sarah Ludford, Thomas Mann, Poul Nyrup Rasmussen, Kristian Vigenin
<b>Substitute(s) under Rule 178(2) present for the final vote</b>	Florencio Luque Aguilar