It’s high time to create a truly *European* System of Financial Supervisors

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Eight years after it created the Lamfalussy Committee, the French Presidency of the EU Council would in its new tenure be well advised to set up a Committee of wise men to make proposals on upgrading the European supervisory system and laying the groundwork for a European System of Financial Supervisors. The losses suffered by European banks in the US subprime market took many by surprise, and the reaction by the EU Finance Ministers resembles mere short-term plumbing. A clear, long-term vision is needed to fundamentally adapt the European framework to prevent these shocks from happening again. The credibility of the EU’s single financial market is at stake.

Ten years into monetary union, the turmoil in the markets has exposed the fact that financial supervision has not kept pace with market integration. The losses faced by European banks in one single asset class affect the stability of the entire European financial system, but the structure for responding to these losses is almost entirely national. A *European* view of risk exposures, a *European* prudential oversight capacity, a *European* structure to allow for rapid exchange of information and a clear assignment of supervisory responsibilities are far from being in place.

EU finance ministers have, in their roadmap on the EU arrangement for financial stability, set forward a detailed agenda on how and by when to alter certain arrangements or regulatory measures. Their work, however, is conditioned by one imperative, i.e. any action must respect the current institutional structure, meaning that the present supervisory framework cannot be “unbalanced”, to take the Council’s wording. It is clear, however, that in reaction to such imbalances in the European (and global) banking system, a more drastic response is needed. How can national supervisors be expected to pursue a European mandate, if their accountability and financing structure is entirely national? In addition, notwithstanding more than 15 years of European financial market integration, the statutes, competences, enforcement and sanctioning powers of supervisors continue to differ importantly. Creating European colleges of supervisors, as was proposed by the Ministers during their May meeting, is thus asking supervisors to drive a car fitted out with different tire brands and sizes.

In this context, the incoming French Presidency could, in line with its strong interest in financial stability issues, commission a study to draft a blueprint for the EU’s future

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regulatory and supervisory structure. As with the Paulson Report in the US, the study could focus on short-term and long-term issues to modernise the EU’s regulatory structure. The EU has been discussing financial regulation for about 20 years, but has never formally harmonised the objectives of supervision. From here, it should be able to come up with a proposal for a model for European supervision, taking into account the European setting and the experiences with supervisory structures worldwide.

The study would draw a roadmap on how to move from the present structure to a European System of Financial Supervisors. The roadmap should set the phases for the creation of the institutional structure for the ESFS, with different target dates, its functions and operations, the financing, the role of the centre as compared to the constituent entities, etc. To those who fear this would become a single European FSA, it would be important to stress the plurality of this undertaking, but working on the basis of harmonised principles and tools. The study should also clearly examine in which areas a single approach is more important than others.

Before the market turmoil, it was argued that the current decentralised structure fitted Europe best, as regulatory competition ensured that financial supervision stayed in line with market development. The last months have demonstrated how too much regulatory competition, or the lack of a more unified approach, can harm the interests of European financial markets overall. Different approaches to liquidity assistance provoked a bank run in the UK, non-consolidated supervision necessitated a bail-out in Germany, the absence of an exchange of supervisory information and of a more European oversight led to losses in European banking exceeding $200 billion. These failings have badly damaged the reputation of Europe’s financial market project.

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