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Financial supervision is not well served by half-baked solutions

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The decisions taken by the EU finance ministers at the Ecofin Council meeting in December 2007, in response to the turmoil in the markets, highlight the urgent need to subject the current European supervisory set-up to a more radical review. The measures proposed and the mandates given to the Commission and the supervisory committees constitute little more than short-term plumbing, lacking any long-term vision and a coherent institutional framework. The clearest example of this short-sightedness is the move to allow supervisory committees to take decisions by majority vote. Although this move is to be welcomed, it lacks any legal basis, as it concerns committees that are empowered to act merely in an advisory capacity, and whose advice can thus be ignored by member states, as some have already implied is their intention.

The EU finance ministers managed to react rapidly to the financial market crisis. The informal Ecofin in Oporto in September laid the basis for a co-called 'roadmap', which was adopted in October regarding European financial stability arrangements. The review of the Lamfalussy framework by the December Ecofin allowed ministers to evaluate the supervisory set-up under the current circumstances. This review process resulted in an enormous agenda of actions to be taken by the European Commission and the Level 3 Committees over the coming months.

The October Ecofin Council decided on common principles for cross-border financial crisis management and on a roadmap to practically enhance supervisory cooperation. The common principles aim to protect the stability of the financial system and to minimise harmful impacts on the economy. Ministers are at pains to insist that they will "carefully cooperate" in the case of a cross-border crisis and will react "based on common terminology and on a common analytical framework", but this language seems to mask important differences in approach, and underscores the need for more binding common rules.

The concrete roadmap designed to reach agreement on these principles sheds light on just how much still needs to be done. Member states are 'encouraged' to sign '*voluntary* cooperation arrangements' as soon as possible. In the course of 2008, the Commission should propose ways to clarify cooperation obligations amongst authorities, covering information-sharing and day-to-day supervision. This highlights how much the exchange of supervisory information is a problem in the EU and how little progress along these lines has been achieved to date. The mandate also calls upon the Commission to clarify the scope of the EU's deposit guarantee directive, which proved to be clearly insufficient in light of the Northern Rock failure.

The December Ecofin Council spelled out the role of the regulatory and supervisory Committees in this context. It assigned several near-impossible tasks: for example, the European Commission was asked to consider various options to strengthen the Level 3

Committees "without unbalancing the current institutional structure", and the Level 3 Committees were requested to strengthen the national application of their guidelines "without changing their legally non-binding nature", and to enhance their efficiency "by introducing (...) qualified majority voting where necessary". A further illustration of this entirely contradictory set of expectations is the demand to the Level 3 Committees to analyse the options of "*voluntary delegation* of supervisory competences". On the other hand, formal recognition of their role is implied by Ecofin's demand to the European Commission that it considers financial support under the EU budget for the Level 3 Committees.

One minister, Tommaso Padoa-Schioppa, courageously denounced this contradictory situation in a letter to all his European colleagues by calling for formal changes in EU legislation to entrust the Level 3 Committees with the powers to adopt binding decisions, and to endow them with adequate financial and human resources to perform their tasks. He observed that, in view of the recent financial market turmoil, the European financial system was still unable to effectively respond to the challenges of a globally integrated market. Voluntary agreements, the Italian minister remarked, proved incapable of ensuring an efficient area-wide supervisory teamwork during crisis episodes. The Level 3 Committees should therefore be turned into agencies, with the powers to set binding standards and to take decisions in a limited number of areas.

While the changes introduced in 2001 with the Lamfalussy approach were a decisive step forward, the recent financial market turmoil has highlighted the need to take a further quantum step in order to achieve genuine European financial market supervision. The Level 3 Committees have fulfilled an extremely useful role in this direction, but further market integration requires a substantial upgrading of their role from the purely advisory function they fulfil today. The Italian finance minister speaks about minor adjustments to Community law, but the problems encountered with the exchange of supervisory information amongst authorities, the delegation of supervisory tasks, the need for an authority to be capable of exercising an EU-wide mandate and take EU-wide supervisory decisions, all call for substantial changes to the current set-up, allowing for full transparency and clarity in the division of responsibilities. In short, the cause of financial supervision is not well served by half-baked solutions.