International and European Co-operation for Prudential Supervision

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Introduction

The issue relating to international prudential co-operation has attracted growing attention in the last years. The issue is not a new one since the first forms of cross-border co-operation are almost thirty years old and the cause of this interest should then be explained against the background of the increasing development of international financial activity. Between 1985 and 1998, the stock of public and private-sector bonds in the G-10 countries grew from 90 to 127 per cent of their combined GDP, the capitalization of their stock markets from 30 to 97 per cent. The ratio between overseas and domestic banking loans grew from 34 to 40 per cent in the '90. The flow of new loans originating in countries reporting to the BIS – namely the industrial countries and the leading off-shore centres – and destined for non-residents peaked at $1,100 billion in 1997. Most of the total amount was accounted for by interbank transactions.

But apart large volumes, international financial activities have also other important features: there is a close interrelation across markets; products and techniques are more sophisticated; intermediaries are changing their characteristics for more complex forms.

National regulators and supervisors are aware that it is not possible to cope with these developments without strengthening international co-operation. The Asian crisis in 1997 revolutionized the conventional wisdom according to which local prudential problems should remain local issues, highlighting that a prudential shock may have global economic repercussions.

Thus, more attention has been dedicated to international systemic risk and to how national authorities may cope with it, going beyond the simple mandating of minimum capital adequacy international standards. In other words, supervisory authorities are increasingly focused on international financial stability and on the ways to improve it thanks to an enhanced co-operation.

The European situation makes no exception to these trends. The European Union is well ahead on the path for integrating national financial markets into a Single Market. Financial operators enjoy complete freedom of movement across Member States while the introduction of the single currency offered new opportunity of business all over the Continent.

However, European prudential regulators and supervisors still face many challenges in ensuring growth and stability. There are many barriers that hinder a complete integration because legal, cultural and tax policy differences are still very strong. Furthermore, with the accession of new Member States from Eastern Europe, these differences will be even more evident considering the specific history of these countries. As a consequence, cross-border co-operation is an essential tool to overcome the obstacles to further integration and ensure proper governance to the European financial system.

This paper will provide in the first place an overlook at the principles underlying international supervisory co-operation. Then it will subsequently review the supervisory forms of collaboration, at international level. It will provide a specific description of the co-operation practices in the European Union, placing the emphasis on the newly approved reform for regulatory and

* The views expressed here are those of the author, and do not necessarily reflect those of the Bank of Italy. The author would like to thank G. Godano, L. Teo, M. Trapanese and S.Vori for their valuable comments on earlier versions of the paper; the author remains responsible for any error.


supervisory co-operation. Finally, the paper will focus on international co-operation in crisis management.

1. The Principles of International Supervisory Co-operation

In the aftermath of Bretton Woods’ system collapse and the increasing volatility of capital flows, major industrial States became aware of the need for coordination among supervisory authorities. The approach used was based on a step-by-step method, according to which it was important to effectively supervise the cross-border activities of banking and financial intermediaries without losing the traditional perspective of a prudential sovereignty exercised by national authorities.

There was an implicit choice to use general principles rather than predefined forms of co-operation. These principles are incorporated in domestic law according to particular national circumstances. This approach facilitates the ability to reach consensus among States and, at the same time, it leaves room for a certain freedom in adapting the principles to the domestic situation.

An example of these principles can be the Basle Concordat of 1975 which stated that, firstly, no foreign banking establishment should escape supervision; and secondly, that the supervision should be adequate. It’s clear how simple these two principles are. But, at the same time, they express an “essential truth” that constitutes the basis of international co-operation: without them current structures wouldn’t exist.

The Basle Concordat was revised in 1983 to introduce the principle of consolidated supervision, according to which home country authorities have a primary responsibility in conducting supervisory control. This led to the spread of the home country control’s approach which nowadays is a normal procedure for every country that participates actively in prudential co-operation.

More recently, the Basel Committee’s “Core Principles for Effective Banking Supervision” of 1997 have reformulated the basic assumptions underlying international banking supervisory co-operation. The Core Principles provide that national authorities must exercise a consolidated supervision over internationally active banking groups, and that there must be close contacts with host country supervisory authorities, which are obliged to apply to foreign banks the same prudential standards required of domestic institutions.

Also the European Community (EC) has affirmed the basic principle of home-host countries sharing of responsibilities, but moving from a different starting point. The home country control principle has been incorporated in all the major financial directives (89/646/EEC and 93/22/EC) as a consequence of the evolution of the European Court’s case law. To solve the difficult question of legislative convergence among Member States, the European Court of Justice acknowledged, in the case of the Cassis de Dijon, the possibility of a mutual recognition of national legislations, provided that minimal harmonization is reached. The implementation of this scheme leads to the

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3 Report to the Governors on the supervision of banks’ foreign establishments, Basle, 1975, BS/75/44.
6 A rough sketch of the principle was first drawn within the Directive 77/780/EEC; however, an organic view on the matter was achieved only later.
7 Case 120/78, Cassis de Dijon, [1979] ECR 649.
possibility of having the so-called “European Passport” under the aegis of the home country authority which is chiefly responsible for controlling it.

Apparently, the use of general principles such as the ones described could bear the risk of an uneven development of supervisory practices all over the world. In fact, many factors might influence how these principles are transposed in the domestic legislation: evolution of the local financial system; social and political interests; presence of effective supervisory structures; etc. The danger is then represented by possible normative loopholes that favour arbitrage.

Actually, the dimension of this danger is reduced by the presence of international co-operation structures that allow an effective approach to the implementation of international standards. In fact, the need for a real collaboration has forced supervisory authorities to articulate their relationships in a way that allows them to overcome the simple phase of agreeing on general principles. Considering the extension and the sophistication acquired by financial activity in the last twenty years, it is essential to specify how prudential activity should be exercised and to find ways to implement it effectively.

2. International Supervisory Structures

Supervisory structures are the natural complement to agreed general principles. They represent the logical consequence to the establishment of rules that cannot stand without a follow-up which has the task to provide a framework where the principles can be implemented.

2.1 Bilateral Co-operation

Historically, international co-operation has taken two major directions: the establishment of bilateral relationships and the creation of international supervisory fora. Bilateral co-operation encompasses every type of contact linking two supervisory authorities, at an official as well as unofficial level. Hence, it is easy to understand how wide the landscape of these relationships could be. This is the result of a progressive stratification of contacts that involves every layer of the national authorities involved.

Moreover, it is important to stress that bilateral co-operation is very resilient in that it can be arranged according to specific needs and circumstances. Supervisory authorities can develop their relationships with their foreign counterparts according to the overseas presence of national banking or financial intermediaries, the type of activity exercised and the extent to which it is considered useful to have such a relationship.

The bilateral relations can be established through formal or informal links. The spectrum of diplomatic tools available is wide enough to allow supervisory authorities to choose the best suitable solutions. The bilateral experience then shows a widespread use of gentleman’s agreements, exchanges of letters, memorandums of understanding or more formal executive agreements. Banca d’Italia, for example, has concluded informal agreements with some supervisory authorities in South-East Asia in accordance with which prudential interventions, such as the request for information or on-site inspections, are processed on a case-by-case basis and by applying the rule of reciprocity.

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When contacts are more frequent or there is an institutional constraint to respect, as it is the case in the EU, supervisory authorities may prefer to conclude agreements that create a more stable environment. The Memorandum of Understanding (MoU) is the privileged instrument in this respect because it is able to coagulate both characteristics: stability and resilience. Stability is assured by the presence of a formal document, signed by both parties, in which mutual rights and obligations are enshrined. Resilience is reached thanks to the fact that, firstly, MoUs are diplomatic tools that do not need long and complex procedures of signing and modification; secondly, rights and obligations are drafted in general terms, leaving room for specification on a case-by-case basis.

The legal value of MoUs is worth a special consideration. According to article 2(I)(a) of the Vienna Convention on the Law of Treaties of 1969, an international treaty is: “an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation”. The UN International Law Commission has defined a treaty as: “any international agreement in written form, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation (treaty, convention, protocol, convenant, charter, statute, act, declaration, concordat, exchange of notes, agreed minutes, memorandum of agreement, modus vivendi or any other appellation), concluded between two or more States or other subjects of international law”.

From these two definitions, it appears that MoUs should be considered international treaties. In particular, they could belong to the group of so-called executive or administrative agreements, i.e. the agreements which do not need a formal procedure of ratification, but come into force at the moment of signing.

In reality, the text of MoUs normally states a general purpose of greater co-operation between the parties, which takes form in the obligations established in the document, but without granting a binding force to such obligations. In other words, the parties use MoUs as documents that organise their co-operation in an agreed form which, however, is not definitive in the sense that said parties are free to change it in any moment, if and when the need arises. As an example, one can cite the standard formula of many Latin American MoUs which states that: “… ambas autoridades se comprometen a colaborar estrechamente en la consecucion de los objectivos indicados…”. Even more clearly, a recent MoU signed by Nordic countries states that: “… the … authorities commit themselves to co-operate on a best-effort basis on all prudential matters pertaining to cross-border banking establishments”.

Thus, we can conclude that it is difficult to consider binding obligations that are to be implemented and abided by on a best-effort basis by the parties involved. The only real obligation, binding in legal terms, is the one that motivates parties to collaborate and sign the MoU in the first place.

MoUs, with their resilience and reliability, have gained momentum against the background of current financial trends. In this respect, because of the creation of large conglomerates that have

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12 The use of MoU has become so frequent that major international standard setter organizations decided to propose general guidelines to the drafting of the text in order to facilitate the conclusions of these kinds of agreements. See, for the insurance sector, IAIS, A Model Memorandum of Understanding, September 1997; for the banking sector, Basel Committee, Essential elements of a statement of co-operation between banking supervisors, May 2001.
not only a wide diversification of activities, but also a business strategy which crosses domestic borders, supervisory authorities are compelled to find ways to collaborate with their foreign counterparts. Nordic countries, for example, after the large M&A campaign on their markets, are trying out a new form of MoUs that organizes co-operation between more than two parties.

The introduction of framework-MoUs is another example of the possible use of MoUs. Framework-MoUs answer the need of a common supervisory approach in respect of a specific geographical market: it lays down a general supervisory framework that single national authorities must complete with the negotiation of a bilateral MoU in which the general framework finds specification. The EC Commission, for example, has signed a framework-MoU with US authorities on consolidated banking supervision. Another framework-MoU is being negotiated with Switzerland.

2.2 Multilateral Co-operation

The other channel of co-operation is participating in multilateral fora. These bodies usually consist of high-level relevant sectoral authority representatives and offer the opportunity to exchange information, study issues, elaborate common approaches, find common solutions to common problems.

On a global level, the Basle Committee for Banking Supervision has great influence and it is one of the leading organizations. Set up by the G-10 central bank Governors at the end of 1974, the Committee is not a formal supranational authority: it provides a forum for on-going co-operation between member countries’ supervisory authorities. The Committee promotes convergence towards common approaches by formulating broad standards, best practices, guidelines implemented voluntarily by national authorities through their national regulatory structures. Following an approach based on “peer pressure” rather than on legal enforcement authority, the Committee has played a pivot role in coordinating prudential supervision policies at the international level.

From the start, the Committee has worked to improve the quality of banking supervision worldwide. Important criteria have been identified both as a result of the elaboration of general supervisory principles and in response to specific episodes of crises. The Concordat issued in 1975 after the Herstatt Bank failure, and further refined in 1983, after the Ambrosiano affair, and in 1990, stresses the importance of exchanging information among supervisors and defines an allocation of responsibility in supervising international banks based on consolidated supervision and parent authority control. A number of these criteria were reformulated as “Minimum Standards” in 1992, after the collapse of BCCI. In 1997, a set of “Core Principles for Effective Banking Supervision” was issued to spread best banking practices on the largest basis possible, especially among emerging countries.

Capital adequacy has been a major focus of attention for the Committee. In 1988, an agreement was reached on the need to halt the deterioration of international banks’ capital base. With the publication of the Basle Capital Accord, minimum capital standards and a common framework for measuring capital adequacy were established. By raising capital levels, the Accord contributed to strengthen the soundness and stability of the international banking system. Currently, the Accord is

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under revision to render the standards more precise and articulated in order to take the subject’s different risk profile into account.

The International Organisation of Securities Commissions (IOSCO) gathers 164 world securities regulators. Through its permanent structures, the organisation aims at co-operating to promote high standards of regulation in order to maintain just, efficient and sound markets. Furthermore, IOSCO has developed its work towards establishing standards for an effective surveillance of international securities transactions, exchanging information, providing mutual assistance to promote the integrity of markets by rigorously applying said standards and by effectively enforcing against offences.

Among IOSCO’s main papers, is a document which identifies the “Objectives and Principles of Securities Regulations”\textsuperscript{14}. The objectives are three: investor’s protection; efficient and competitive markets; reduction of the systemic risk. To reach these objectives, the document then indicates thirty principles that involve regulators, supervisors, intermediaries and clients.

It is worth reminding that IOSCO is actively working on all major issues for securities’ regulators. The Internet, for example, and its implications have been the object of increasing focus. The organization has produced a document\textsuperscript{15} in which this new phenomenon is analysed and recommendations to cope with its various aspects are suggested. \textit{Inter alia}, it is important to underline the principle according to which jurisdiction over advertising and marketing activities belongs to the authority of the country towards which these activities are targeted.

Another important organization is the International Association of Insurance Supervisors (IAIS) whose membership comprises insurance supervisors from all over the world. Created in 1994, IAIS has been set up to establish common guidelines for members as well as to provide mutual assistance to safeguard the integrity of markets.

Among the documents issued by IAIS, are the “Insurance Core Principles” of 2000 and the “Principles applicable to the Supervision of International Insurers and Insurance Groups and their Cross-Border Business Operations” (Insurance Concordat) of 1999. The former deals with principles for an effective supervision; it is stated clearly that an aspect of this effectiveness is close co-operation between supervisors. The latter follows the example of the Basle Concordat to point out the need for a truly enacted supervision, also at consolidated level, and the opportunity of a close co-operation between home and host authority.

In 1996, following the recommendations of the G-7 Summit in Halifax, the Basle Committee, IOSCO and IAIS created the Joint Forum on Financial Conglomerates. The mandate\textsuperscript{16} of the Joint Forum provides that it is “to draw up proposals for improving co-operation and the exchange of information between bank, securities and insurance supervisors and to work towards developing principles for the future supervision of financial conglomerates”. The original mandate has been broadened in 1999 to take inter-sectoral issues (capital requirements, activity definitions, possible arbitrages, etc.) concerning parent companies into account and to improve the exchange of information between authorities.

\textsuperscript{14} IOSCO, Objectives and Principles of Securities Regulation, Montreal, 1998.

\textsuperscript{15} IOSCO, Securities Activity on the Internet, Montreal, 1998.

\textsuperscript{16} The mandate of the Joint Forum can be visioned on the web sites of the mother organizations: www.bis.org; www.iosco.org; www.iais.org.
Until now, the Joint Forum has worked on defining a set of principles concerning: capital requirements, aiming to avoid the so-called double gearing; sectoral and inter-sectoral exchange of information; the identification of the lead-coordinator among supervisory authorities; etc.

In 1999, following the findings of the Tietmeyer Report \(^\text{17}\) in the aftermath of the Asian crises, the G-7 countries created the Financial Stability Forum (FSF). The Forum seeks to promote international financial stability, improve the functioning of financial markets and reduce systemic risks, co-ordinating the efforts of national authorities and international organizations engaged in financial stability. The FSF meets regularly twice a year to assess issues and vulnerabilities affecting the global financial system and to identify and oversee the actions needed to address them. It reports to G-7 Finance Ministers and Central Bank Governors. Representatives from other multilateral fora (e.g., the Basle Committee) participate in the FSF meetings.


The governance structure for financial regulation in the European Union relies on two building blocks: harmonised regulation and national supervision.

In the last twenty years, even though the EU Treaty does not contain an explicit allocation of regulatory powers to the European institutions, financial regulation in EU countries has been increasingly depending on the directives approved in Brussels. Since the publication of the White Paper on the Single Market \(^\text{18}\) in 1985, financial integration has been indicated as a priority to achieve the single market, considering the economic importance of financial services. As a consequence, Member States and the European Commission have been working to introduce a core set of common concepts and rules.

The financial single market works according to the three general principles of: (i) minimum harmonization of rules; (ii) mutual recognition of authorisation and supervisory structure; (iii) home-country control. On the basis of a common notion of financial intermediaries, objective criteria for licensing, branching and the cross-border provision of services have been harmonized. Basic prudential requirements in relation to capital adequacy and large exposures have been elaborated and implemented in all Member States, according to a common definition of own funds. Supervision has to be performed both on an individual and a consolidated basis.

On the other hand, financial supervision remains at national level. Reflecting the different national historical traditions and the specific features of national financial systems throughout the continent, prudential supervision is inspired by two main principles:

- **Subsidiarity**: the principle stems from the fact that supervisory tasks are best performed as close as possible to supervised entities and that there still exists important differences in national financial systems and practices (i.e. legislative settings, deposit insurance systems) \(^\text{19}\). Given the


\(^\text{19}\) Subsidiarity is enshrined in the EU Treaty (article 5) as general guiding principle for the European Community policies. According to article 5, the Community shall take action only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and therefore be better achieved by the Community itself. See further, on the implementation of the principle, K. Lenaerts, P. Van Ypersele, *Le principe de subsidiarité et son contexte: étude de l’article 3B du Traité CE*, in *Cahiers de droit européen*, 1995: 2.
predominance of local intermediaries and local markets, the main issue in supervision continues
to be the need to maintain a close relation between supervisors and supervised institutions at the
local level. The national allocation of supervisory responsibilities also reflects the consideration
that the impact of financial crises is borne by the public finances of single member States;

- **Neutrality:** Members States are free to adopt the model they prefer for the allocation of
regulatory, supervisory and financial stability functions (e.g., a single supervisor, vertical
supervision, horizontal supervision, etc.).

With the introduction of the Euro, the need for further financial integration has been more pressing.
But, at the same time, this has not implied major changes in the basic governance structure. The
Maastricht Treaty has confirmed the described approach, granting the European Central Bank an
advisory role with respect to EU and national financial regulation; the ECB is not responsible for
prudential supervision but “contributes to the smooth conduct of policies pursued by the competent
authorities relating to the prudential supervision of credit institutions and the stability of the
financial system” (art. 105.5 of the EC Treaty)\(^\text{20}\). The draft Constitution presently debated within
the InterGovernmental Conference does not propose to alter this framework.

Against this background, co-operation among supervisory authorities is a logical consequence of
the harmonization of national practices: on the one hand, the existence of common rules requires a
consistent approach in their implementation throughout the European Union; on the other hand, the
increasing scope of cross-border activity, together with the creation of multi-business
conglomerates, calls for extensive reliance on co-operation, sector and cross-sector.

The scheme of co-operation is tailored on the traditional bivalence: bilateral-multilateral.

Memorandums of Understanding are the key tool for bilateral co-operation. They function as the
basic channel for exchanging information between home and host-country supervisors and
facilitating consolidated supervision. MoUs normally respect a widely agreed form that includes
practical provisions concerning the establishment of branches and subsidiaries and cross-border
investigations.

A more recent event is the diffusion of multilateral MoUs, i.e. a MoU signed by more than two
parties. These kind of documents are a hybrid form of co-operation since they are a multilateral
instrument that could be invoked in bilateral relationships. Their advantage is that they are a
flexible tool which provides a framework for creating or developing supervisory co-operation along
general guidelines applicable to all parties which are allowed to adjust and implement them on a
case-by-case basis. Recent examples of multilateral MoUs are the “MoU on co-operation between
payment system overseers and banking supervisors in stage three of EMU”, signed in April 2001
and “MoU on high level principles of co-operation between banking supervisors and central banks
of the EU in crisis management” signed in March 2003\(^\text{21}\).

The other channel of collaboration is the participation in multilateral fora. Since its very inception,
the European Community provided the occasion for multilateral talks among its Member States and,
with the collapse of Bretton Woods’ system and the gradual set-up of the common market, the
necessity for a better co-ordination among supervisory authorities became even more impelling.

\(^{20}\) However, article 105.6 of the EC Treaty provides the possibility that the Council, acting unanimously on a proposal
from the European Commission and after consulting the ECB and the European Parliament, may confer specific
prudential tasks to the ECB (so-called enabling clause).

\(^{21}\) See further par. 4.1.
The banking sector is the main example of close multilateral co-operation among European supervisory authorities: the Groupe de Contact (GdC) has been the first example, followed by the constitution of the Banking Advisory Committee (BAC) and, in more recent years, by the Banking Supervision Committee (BSC), under the aegis of the ECB.

The GdC is an important forum for discussions relating to day-to-day businesses and individual institution. Created in 1972, its existence has been formalised both by the First and the Second Banking Coordination Directives. Made up of senior officials from the Members States, plus Liechtenstein, Iceland and Norway, the Groupe has different tasks relating namely to: the exchange of information about particular problem institutions; the updating on developments in national supervisory arrangements, including administrative practices; the drafting of comparative studies on different aspects of supervisory practice. The GdC can exert a technical advisory task to the BAC and the EC Commission on major banking legislative proposals.

The BAC is an advisory body to the Commission and it has the institutional task of examining each relevant proposal in the banking field. Its creation has been provided for by article 11 of Directive 77/780/EEC and its role has been confirmed by Directive 89/646/EEC. The Committee has a general advisory competence on all of the Commission’s relevant financial legislative proposals. At the same time, according to the comitology regulatory procedure, BAC is a technical committee that advises the Commission on the executive measures to be taken to implement banking directives.

Finally, the BSC is the relevant forum for addressing the issues raised by the beginning of the third phase of the Economic and Monetary Union (EMU), namely the relationship between national supervisory authorities and the ECB, since supervisory powers have not been centralised like the monetary policy and they belong to the domestic jurisdiction of Member States. Set up in October 1998 as an ESCB committee, the BSC has a twofold mandate: firstly, it is to facilitate co-operation between the Eurosystem and national supervisory authorities; secondly, it must foster co-operation between supervisors, beyond the interests of the Eurosystem. The accomplishment of these tasks is favoured by the fact that BSC’s members are both national supervisory authorities and NCBs that do not have supervisory tasks.

In the other financial sectors multilateral co-operation has a shorter track-record because cross-border activities have been developing only in more recent years. However, both the securities and the insurance sectors have followed the example of the banking sector in setting up European multilateral fora of co-ordination. For the securities sector, it is worth mentioning the High Level Securities Supervisors Committee (HLSSC), created to assist and advise the Commission on policy issues relating to securities markets and the development of the relevant European legislation, and the UCITS Contact Committee, set up to assist the Commission and the Member States in the

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23 The comitology procedure is provided for by decision 1999/468/EC of 28th June 1999 and deals with the procedures to use in issuing measures to implement EC legislation. In particular, the decision organises three types of procedures (regulatory procedure, management procedure, advisory procedure) in which national authorities, through participation in technical committees, have a different degree of involvement in drafting such executive measures.
25 For a complete description of EU co-operation structure for these sectors see European Commission, Institutional Arrangements for the Regulation and Supervision of the Financial Sector, Brussels, 1999.
implementation of the UCITS directive. In the insurance sector, the directive on direct insurance created the Insurance Committee (IC) with the same tasks as the BAC (advisor to the Commission and comitology functions).

The multilateral structure just described has been working very effectively, providing an invaluable networks of contacts for national supervisory authorities with their European counterparties. These contacts have not only favoured a better implementation of EU financial legislation, but they have also spurred a progressive convergence of supervisory practices, enhancing consistency throughout the continent. This was confirmed by the Brouwer I Report which concludes that “the existing institutional arrangements provide a coherent and flexible basis for safeguarding financial stability in Europe”.

However, with the launch of the project aimed at creating a Single Market for financial services, elaborated by the Member States and the European Commission in the late ’90, Community actors have begun to re-design the approach to co-operation within the EU, placing increasing emphasis on the need for even greater uniformity in prudential practices in order to create a level playing field for financial intermediaries all over the EU while improving effectiveness in supervisory actions. These are the main reasons inspiring the reforms proposed by the Lamfalussy Report in 2001 and the Economic and Financial Committee (EFC) Report in 2002.

3.1 The Single Market for Financial Services

The notion of “Single Market for Financial Services” refers to the situation created after 1993 according to which a European financial intermediary, lawfully established in one Member State, may enjoy the use of the “European passport” and then offer its services throughout the EU. This offer may take the form of a physical establishment in another Member State or of the provision of cross-border services.

Since 1993, national markets have progressively opened to intermediaries coming from other Member States. In France, for instance, there were 59 branches of EU financial intermediaries in 2000 compared to 46 in 1995, while for subsidiaries the number increased from 73 to 108 in the same period. In Spain, for the same period 1995-2000, the numbers confirm the increase: from 36 to 42 branches, and from 20 to 38 subsidiaries.

These data confirm the success of a project which was started with the introduction of the Second Banking Co-ordination Directive. If the idea was to offer means to facilitate the free movement, the results went far beyond any expectation, creating a solid legislative framework on which it has been

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28 For the sake of completeness, it is important to recall that European insurance authorities set up in 1957 a Conference of Insurance Supervisory Authorities of the EEC as an informal discussion forum, but it never acquired a decisive role for multilateral co-operation.
30 On the need for more efficiency in market structures within the EU see Report by the Economic and Financial Committee on EU Financial Integration, May 2002, in Economic Papers of the European Commission, n. 171.
31 Elaboration on ECB data (2000).
possible to build strong commercial intra-European relations, while spurring at the same time other legislative initiatives which have enriched and completed the picture. In this respect, it is possible to recall directive 93/22/EEC on investment services, directive 94/19/EC on deposit-guarantee schemes, directive 95/26/EC post-BCCI, directive 97/9/EC on investor-compensation schemes.

This success was not easy to reach and it had to reckon with many difficulties. As pointed out by Dassesse\textsuperscript{32}, the approach introduced by the directive 89/646/EEC raised many issues: a) the extent of the notification procedure; b) the exact scope of general interest clause; c) the clear distinction between physical establishment and free provision of cross-border services in specific cases (e.g. electronic transactions). The European Commission tried to answer to some of these questions with an Interpretative Communication, looking for more consistency in the implementation of legislative acts across Member States.

But far more difficult were the political issues linked to the creation of the Single Market for Financial Services and the introduction of the single currency. Is it enough to have a co-ordination of general principles to make the Single Market work or it is necessary to push integration beyond? What should be the relationship between legislative integration and market integration? The former should spur the latter or viceversa? And again, what’s the role of national authorities in a highly integrated environment such as the Single Market?

Member States and European Institutions have tried to answer to some of these questions designing a strategy aimed at accelerating the integration within the Single Market. Thus, the European Council of Cardiff in 1998 requested the European Commission “…to table a framework for action … to improve the single market in financial services”\textsuperscript{33}.

In 1999, the European Commission launched the Financial Services Action Plan (FSAP)\textsuperscript{34}. According to the document of the Commission, “… with the introduction of the euro, there is a unique window of opportunity to equip the EU with a modern financial apparatus in which the cost of capital and financial intermediation are kept to a minimum”. Then, it was necessary to prepare an articulated legislative plan in order to review the regulatory framework in the area of financial services. The European Council held in Lisbon in 2000, endorsing the Plan, indicated 2005 as the final deadline for its completion\textsuperscript{35}.

The content of the Plan is very heterogeneous since it contains a large variety of measures. First of all, it covers both the banking sector and the securities sector. It contains wholesale markets as well as retail markets provisions. There are measures dedicated to the good functioning of clearing and settlement systems.

From the technical point of view, it is important to emphasize that all legislative measures included in the FSAP are still based on the original principles of “minimum harmonization+mutual recognition+home country control”. The repartition of competence between the Member States and the European Community is apparently still built around this basic scheme.

In reality, the scheme has acquired a new element with the creation of the Financial Services Policy Group (FSPG). The Group, composed by representatives of the national Finance Ministries and the European Commission, has the task of coordinating the activities linked to the accomplishment of the FSAP.

In its work, the FSPG has stressed its guiding role of policy planner. Within this Group, Member States and the European Commission have tried to agree on political guidelines to be transposed in the legislative measures of the Plan in order not only to facilitate the adoption of the single measure, but also to influence the transposition at national level. It is also interesting to note that the guidelines issued by the FSPG are political in essence. In fact, the membership of the Group is not open to technical national authorities. This choice lies in the desire to centralise the strategic decision-making process, shielding it from any national or sectoral interference.

The creation of the FSPG is then a turning point in the governance structure of the European financial regulatory system since it provides the Single Market for financial services with a strong political decision centre. National interests are downgraded in favour of a more supranational approach and, most of all, Member States loose their exclusive competence in the transposition of legislative acts. The presence of the FSPG expresses the need for a better and closer co-ordination in both the drafting and the implementation of EU acts because the degree of integration depends not only on the existence of harmonised rules but also on the convergence of national implementation practices.

3.2 The Lamfalussy Report

In 2000, the EcoFin Council requested a group of so-called Wise Men, chaired by Baron A. Lamfalussy, to propose practical arrangements for implementation of the Community rules concerning the areas identified by the FSAP. In particular, the group was requested to consider how to achieve a more effective approach towards transposition and implementation for areas like: the listing of companies, the public offer of securities and requirements relating to reporting by issuers, the conduct of cross-border financial operations, the day-to-day operation of regulated markets, the protection of consumers and investors in the provision of investment services, and the integrity of the market.

The Wise Men, after extensive consultations with national authorities and the financial industry, presented their conclusions in a Final Report (known also as the Lamfalussy Report) which was formally adopted by the EU Council during the Stockholm summit in march 2001. Despite the narrow mandate given by the EcoFin Council, the Report conducts a comprehensive analysis on the state of the Internal Market, evaluating the advantages of a greater integration in the financial services area and the factors that hinder this process.

According to the Final Report, an integrated European financial market would provide a more rational allocation of capital, allowing greater liquidity access to companies and lowering the cost of capital; consumers would have greater opportunity of investment with higher net yields. At the macroeconomic level, these benefits would imply an increased productivity of capital and labour, enhancing the potential for stronger GDP growth and job creation.

36 The other wise men were C. Herkströter, L.A. Rojo, B. Ryden, L. Spaventa, N. Walter e N. Wicks.
However, there are still too many factors that slow market integration. The Wise Men point out that many financial areas lack a European-wide regulation; that very often the implementation of the European legislation lacks consistency across Member States, causing serious interpretation problems; that the legislative procedure is too burdensome. Focusing on this last issue, the Report considers that the present procedure has a number of major shortcomings, being very slow, not flexible enough to take into account market developments and unable to distinguish between core, enduring, principles and practical, day to day, implementing rules.

The solution proposed by the Report to solve these questions is a different approach to regulatory and supervisory procedures. In the first place, the document recognises two layers in the legislation related to financial markets: basic political choices that can be translated into broad but sufficiently precise framework norms (level 1); and the more detailed technical measures, in full conformity with this framework, needed to implement the objectives pursued by the legislation (level 2). This distinction, without any modification to the EU Treaty, would allow EU Institutions to design rules in a faster and more flexible way because the level 1 legislative acts will be limited to general principles while delegating detailed regulation to further work of technical bodies.

In this respect, the Report specifies that level 2 would see at work the European Commission and representatives of national Finance Ministries to define, propose and decide on the implementing details of framework level 1 legislative acts. In particular, according to the comitology procedure, the European Commission will prepare regulatory proposals in close co-operation with a committee composed by national regulators and will issue the technical measures with the approval of a committee composed by representatives of national Finance Ministries.

Levels 1 and 2 will complemented by a level 3 and a level 4. The level 3, centred on the work of the committee of national regulators, would have the task of ensuring the consistency of the day to day transposition and implementation of level 1 and 2 rules. In other words, the national regulators’ committee will have to produce guidelines and best practices for the administrative regulations to be adopted at the national level as well as issue joint interpretative recommendations, even on matters not covered by EU legislation. This would assure a very high degree of supervisory and regulatory convergence among Member States.

Finally, the level 4 concerns strengthening the enforcement of Community rules, improving the relevant powers of European Institutions. In particular, the Final Report calls for a better monitoring of national developments by the European Commission.

The EU Council’s endorsement of the Final Report has allowed a quick implementation of the Lamfalussy approach in the securities sector. In June 2001, the European Commission\textsuperscript{38} established the two committees foreseen in the document of the Wise Men: the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR), replacing the HLSS and the UCITS Contact Committee. In February 2002, after an inter-institutional agreement between the EU Council, the European Commission and the European Parliament\textsuperscript{39}, the reform for the securities sector was finalised.


\textsuperscript{39} The inter-institutional agreement was necessary to overcome the objections of the European Parliament on the compatibility of the reform with the provisions of the EU Treaty. The agreement is based on temporal limitation to the regulatory powers (level 2) of the European Commission (so-called sunset clause). See for further details Intervention by President Romano Prodi to the European Parliament’s plenary session, Strasbourg, 5\textsuperscript{th} February 2002, available at europa.eu.int/rapid.
3.3 The EFC Report

The Lamfalussy Report set an important precedent in the area of financial services because the analysis on which it is built clearly states issues which are very often replicated, although with specific features and with different degree of incidence, in each of the other financial sectors. Problems like fragmentation, high costs of transaction, legal differences affect also banking and insurance services. But similarities are to be found also in the problems concerning the regulatory process and the relationships among supervisory authorities. In 2000, the Brouwer I Report already called for some enhancements in European supervisory structures mainly strengthening cross-sector co-operation on large financial groups, improving the exchange of information among different supervisory authorities, and with central banks, and working on convergence of supervisory practices. In 2001, the Brouwer II Report on crisis management confirmed the need for closer co-operation in order to prevent and properly manage systemic crisis.

As a consequence, the EcoFin Council feel compelled to repeat the exercise started with the Lamfalussy Report, looking into the possibility of introducing a major regulatory reform also for the banking and the insurance sector. In May 2002, the EFC received the mandate to draft a report suggesting possible options to make EU arrangements for financial regulation, supervision and stability more efficient.

The mandate given to the EFC contained very precise terms of references. The new arrangements should have respected the allocation of powers and responsibilities set out in the EU Treaty, the appropriate accountability to EU institutions, the principle of subsidiarity (“…since supervisory tasks are best performed as close as possible to supervised entities and since financial crises may have implications for public finances”) and the principle of neutrality.

The work of the EFC has been aimed not only at ensuring consistency among the different financial sectors (banking, securities, insurance and financial conglomerates), but also at creating a more general picture where the technical work of supervisory authorities goes hand in hand with the strategic objectives set by the EcoFin Council. The underlying idea behind the entire project was far more ambitious than the simple enhancing of sectoral and inter-sectoral regulatory action because it wanted to create an articulated structure able to make the regulatory action answer to inputs and suggestions coming from the design of European policy in the financial services area. In other words, the EFC was entrusted by the EcoFin with the task of redesign the European financial governance structure.

However, the reform is not aimed at creating a centralisation of supervisory and regulatory responsibilities, in accordance with the neutrality and subsidiarity principles. The structure will be based on multilateral fora where participating national authorities will formally retain their competence in regulatory and supervisory matters.

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42 ECOFIN Council, Mandate to the Economic and Financial Committee for work on EU financial stability, supervision and integration, 7 May 2002.
The first recommendation of the EFC Report is the extension of the Lamfalussy approach to the banking and insurance sectors. This implies that the four level approach is applied with the simultaneous creation of levels 2 and 3 sectoral committees. The level 2 committees will be similar to the ESC: they would act as a regulatory committees according to the 1999 Council comitology decision and they should provide advice to the Commission on draft legislative texts. The level 3 committees will be similar to CESR: they should advise the Commission in preparing draft legislative texts; promote consistent implementation of EU acts, supervisory convergence and best practices in Member States; and provide an effective operational network to enhance day-to-day supervision, also including the exchange of information.

As concerns level 3 banking committee, it is important to underline the participation of national central banks even if they do not have supervisory responsibilities in their country. This choice was dictated by the desire to profit from synergies between banking supervision and central banking, like⁴⁴.

The Report provides also the creation of a level 2 committee for financial conglomerates. This committee will assume the tasks provided for in directive 2002/87/EC on financial conglomerates⁴⁵, namely. A level 3 committee for financial conglomerates was not deemed necessary since its functions are performed by periodical joint meetings of the three sectoral level 3 committees.

The new structure built according the Lamfalussy approach will replace in part the old multilateral co-operation. The BAC as well as the IC will be suppressed. Representatives of the BSC and of the Groupe de Contact will be allowed to sit in the level 3 banking committee as observers. The Groupe de Contact should continue its activities and also act as the main working group of the level 3 banking committee.

<table>
<thead>
<tr>
<th>Level</th>
<th>Banking Sector</th>
<th>Insurance and Pensions</th>
<th>Securities and UCITS</th>
<th>Financial Conglomerates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 2</td>
<td>European Banking Committee (EBC)</td>
<td>European Insurance Committee (EIC)</td>
<td>European Securities Committee (ESC)</td>
<td>Financial Conglomerate Committee (FCC)</td>
</tr>
<tr>
<td>Level 3</td>
<td>Committee of European Banking Regulators (CEBS)</td>
<td>Committee of European Insurance and Pensions (CEIOPS)</td>
<td>Committee of European Securities Regulators (CESR)</td>
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</tbody>
</table>

The second recommendation of the EFC Report is the establishment of a new structure entrusted with financial stability and strategic policy tasks. The document creates a new committee, the Financial Services Committee (FSC), which will replace the Financial Services Policy Group. The FSC fills the gap between the political and technical regulatory levels, and provide for cross-sectoral strategic reflection, separate from the legislative process. In particular, the new committee should help the EcoFin Council to define the medium and long term strategy for financial services issues; consider “hot” short-term issues; and assess progress and implementation of the strategy set. It should also provide the EcoFin Council with political advice and oversight on both internal issues.

(e.g., the Single Market for Financial Services) and external issues (e.g., WTO and enlargement issues). The FSC is composed by representatives of national Finance Ministries and the European Commission, while the ECB and chairs of level 2 and 3 committees will have observers’ status.

Thus, the FSC should ideally act as a think-tank of the EcoFin Council for strategic planning in the area of financial services, evaluating areas of interest, setting priorities, elaborating strategies and monitoring their implementation. In the view of the EFC, the role of this committee is particularly important to guide the integration of European financial markets even though its close dependency on the EcoFin Council (e.g., the composition of the FSC reflects the composition of the EcoFin Council) and its informal legal status may limit its scope of action.

The EFC Report deals also with the issue related to financial stability, entrusting the EFC with the task of advising the EcoFin Council, in accordance with article 114.2 of the EU Treaty46. The FSC will contribute actively to the work of the EFC on such issue.

The attention given by the Report to the question of financial stability answers to a need for better knowledge on shaping factors and driving forces behind current developments in financial markets. Drawing the lessons from the crises of last years, Governments and supervisory authorities are increasingly aware of the importance of monitoring not only macroeconomics variables but also the dynamics underlying financial markets47, given their disruptive potential for economic systems. Then, the EFC Report considers important to provide the EU with a system of financial stability surveillance in order to keep update the EcoFin Council on any relevant development.

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46 Article 114.2 states that, among other things, “The Economic and Financial Committee shall … keep under review the economic and financial situation of the Member States and of the Community and report regularly thereon to the Council and the Commission”.

New European Legislative and Supervisory Architecture

- **ECOFIN**
  - Represents Finance Ministries, European Commission

- **ECB**
  - Represents Finance Ministries, European Commission

- **FSC** - Financial Services Committee
  - Represents Finance Ministries, European Commission

- **EFC** - Economic and Financial Committee
  - Represents Finance Ministries, NCB, ECB, European Commission

- **COREPER**

- **EUROPEAN COMMISSION**

- **LEVEL 1**
  - **ECB**
  - **FSC** - Financial Services Committee
  - **EFC** - Economic and Financial Committee

- **LEVEL 2**
  - **Banking Supervision Committee (BSC)**
    - Representatives of NCB and national banking supervisory authorities; ECB
  - **European Banking Committee (EBC)**
  - **European Securities Committee (ESC)**
  - **European Insurance Committee (EIC)**
  - **Financial Conglomerates Committee (FCC)**

- **LEVEL 3**
  - **Groupe de Contact (GdC)**
    - Representatives of national banking supervisory authorities
  - **CEBS** - Committee of European Banking Supervisors
  - **CESR** - Committee of European Securities Regulators
  - **CEIOPS** - Committee of European Insurance and Occupational Pension Supervisors

- **Opinion**

- **Directives/Regulations (Co-Decision Procedure)**

- **Representatives of Finance Ministries, European Commission**

- **LEVEL 3 Supervisors Committees**
  - Chairmanship: National Supervisory Authority
  - Members: 1 representative per country of competent sectoral supervisory authority; (for CEBS, 1 representative of NCB)
  - Observers: European Commission; EEA countries; for CEBS, chairs of BSC and Groupe de Contact
The EcoFin Council has endorsed the EFC Report on 3rd December 2002. The EcoFin Council also asked the European Commission to rapidly settle down the institutional arrangements to set up the new committees and make the new structure work. In fact, it necessary not only to formally create the new committees, but also to insert them in the *acquis communautaire*. In this respect, the establishment of the level 2 committees implies the modification of relevant directives, such as the directive 2000/12/EC for the banking sector or the directive for the insurance sector, with the subsequent need to open a legislative process in accordance with article 251 of the EU Treaty. Consequently, works are under way to ensure the passage to the framework. The European Commission set the beginning of 2004 as the final deadline to have all the structures in place.

On the contrary, the establishment of financial stability arrangements are already in place. The FSC have been installed with an EcoFin Council decision of 18 February 2003 and it started it activities in March 2003. Likewise, the EFC held its first formal meeting dedicated to the European financial stability review in March 2003.

It is still difficult to make a thorough evaluation of the reform since many elements still miss and the entire framework should still be tested in the real world. However, some commentators have already express criticism for the complex structure with a multiplicity of committees. If the original idea was to speed up the production of EU financial rules, increasing flexibility and uniformity across Europe, many could be deceived. Lastra notes that regulatory and supervisory co-operation in the EU “…should proceed along the lines of consolidation and streamlining of existing committees, rather than through the creation of new committees, which bring about a duplicity or multiplicity of supervisory forums, often leading to a confusion or to an overlap of lines of responsibility and membership, to a cumbersome and unduly complicated decision-making process and, possibly, to bureaucratic inefficiency”.

These fears are not to be undervalued since many aspects of the Reform should still be clarified, such as the relationships between sectoral level 2 and level 3 committees, the exact role of the FSC or the place reserved to the European Parliament. All these questions have a relevant impact on the regular functioning of the structure since they are connected with the very philosophy on which the Reform is based; thus, they deserve a clear and immediate answer. Furthermore, the new framework should also take into account the participation of the new Member States from 2004 onwards: the increase in the number of participants will make the functioning of the new structure even more complex, posing real viability problems.

4. International Supervisory Co-operation and Crisis Management

Crisis management is an issue that is acquiring growing importance in the area of supervisory co-operation. The dimension and the features of financial crises in the last few years left no doubt on the fact that only a co-ordinated action by all involved actors may offer the possibility of a way out. In fact, the literature agrees on that recent crises are dual in essence: on the one side, there are

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50 In the level 3 banking committee the representation of 25 Member States will imply the participation of over 70 persons for each meeting, considering full members, their technical experts and observers.
macroeconomic imbalances; on the other, there are structural distortions in the functioning of the financial system that not only make these crises more severe, but provoke contagion effects due to the globalisation of financial markets\textsuperscript{52}.

Hence, the issue of good governance in the context of crisis prevention and management is gaining momentum since in these situations of emergencies it is extremely important to manage resources efficiently and to formulate, implement and enforce sound resolution strategies. A growing agreement is developing on the fact that there should be a continuum between governance in normal times and crisis times, because crisis governance is predicated on governance practices in normal times\textsuperscript{53}.

At the same time, it is important to assure a large degree of flexibility since it is always difficult to predict the exact features of the actions needed. Co-operation should be engaged on the basis of general principles which do not pre-empt specific outcomes and leave the authorities free to adapt to current situations.

This approach leads national authorities to draw more attention on the measures to avoid systemic instability, elaborating strategies both to prevent and manage financial crises. In both respects, the supervisory co-operation among foreign authorities acquires a specific role because it allows the exchange of information and the possibility of concerted interventions, defining the role of the different authorities involved.

The exchange of information is vital to allow a permanent and reliable monitoring of international activities of financial intermediaries. The availability of information allows supervisory authorities to verify the soundness conditions of the markets and detect problems before the crisis unfolds. If the crisis is already underway, timely information sharing may define the extent of the problems (i.e., their systemic dimension), what are their specific features and if there is some kind of response by the market or the intermediaries.

As a consequence, there is an international consensus that (i) there should be no obstacles to information sharing between supervisors; (ii) the confidentiality of shared information must be secured; and (iii) supervisors should take a proactive stance toward co-operation, both in providing and in requesting assistance and information. The three aspects are linked together since the proactive stance is possible only if there are no obstacles or confidentiality problems.

Of course, these issues are deeply intertwined with the design of domestic regulatory frameworks because it implies the existence of rules which allow such exchange and the question about information sharing may then come across other important issues such as the protection of privacy or the duty of disclosure to the Judiciary. Thus, it is impossible to go further than general principles and each specific situation should be handled on case-by-case basis.

However, the Basel Committee invited its Members to have a open approach towards the matter and, in its Report titled “Supervisory Guidance on Dealing with Weak Banks” of March 2002, recommends that co-operation among banking supervisors should be based “on agreements … on information sharing, particularly in a crisis” in order to have access to all relevant information.


Likewise, the IAIS issued a “Supervisory Standard on the Exchange of Information” in January 2002. The document has been designed to clarify the conditions and the requirements insurance supervisors around the world are expected to apply when sharing information between them and with other supervisors. This text draws the attention on the fact that, in emergency conditions, supervisors must make best efforts to speed up the process of information sharing.

The other aspect of international co-operation in financial crisis situation is the repartition of roles between supervisors. When foreign branches or subsidiaries of a financial institution in troubles are involved, there is always the question of understanding who does what. The issue is relevant because it has many consequences not only for supervisors, but also for governments, taxpayers and stakeholders at large. Entrusting crisis management responsibilities implies that actions should be taken to restore stability, bearing all the costs that go with the solution adopted. As a consequence, it is important to have a clear definition of roles in order to ensure effectiveness and to avoid confusion which may worsen the crisis.

The basic definition of roles is attached to the scheme home country supervisor – host country supervisor. The interest at stake by the two supervisors depends very much on the type of crisis they are confronted to since the troubles may arise at the level of the parent company or at the level of the foreign branch or subsidiary. In both cases, supervisors should have a contingency plan that allows timely consultations prior to take supervisory actions.

The Basel Committee’s Report on weak banks makes a distinction based on the type of establishment: in the case of a subsidiary, which is a company incorporated in the host country, host authorities may try, to the extent possible, to protect it by ring-fencing; on the other hand, in the case of a branch, home country authorities bears the main responsibility to assure solvency and ring-fencing by host country authorities may prove ineffective. Nonetheless, in both cases, host authorities may always decide to revoke the license and close all activities conducted by the foreign institution.

4.1 Financial crisis management in the European Union

Member States are familiar with the debate on financial crisis management in the European Union. Europe has suffered the direct or indirect effects of recent financial crises and there is growing awareness on the need for clear and effective strategies in these situations. Moreover, the very integrated environment of the European Union is a favourable ground for crises with cross-border effects: the Brouwer II Report on financial crisis management recognises that, even though the degree of integration in the different markets is uneven, however it is possible to imagine that the unsecured interbank deposit market and the derivatives market may be sufficiently integrated to cause major disruption across Member States.

The issues to which European authorities are faced are the same as those at the more general international level: the timely exchange of information and the repartition of roles. However, these issues acquire a specific significance in the context of the European Union where authorities have to deal with a supranational regulatory framework and the national exercise of supervisory functions. Furthermore, the conduct of a single monetary policy and the existence of tight rules on public deficits should be taken into account when designing national strategies to crisis management.

For many years, national supervisory authorities have relied on bilateral MoUs as the institutional tool to cope with crisis situations. In fact, their scope is wide enough to apply the rules on the exchange of information also to emergency situations and sometimes they even contain some more specific rules on how to organise the co-ordination in case of crisis. However, there is no single European standard in this respect and each Mou is the product of bilateral negotiations adjusted on a case-by-case basis.

More recently, the situation have been partly changed by the entry into force of some EU legislative acts which provide for more specific obligations on national authorities in the event of a crisis. Directive 95/26/EC\(^5\) (so-called post-BCCI directive because it was approved after the BCCI scandal) contains obligations for the exchange of information among European supervisory authorities in all financial sectors and, in the case of the banking sector, even a provision for information sharing between banking supervisors and central banks.

Directives 2001/17/EC\(^6\) and 2001/24/EC\(^7\) provide a European regulatory framework for the reorganisation and winding up of insurance companies and credit institutions. The two directives are based on an approach that centralises all remedial proceedings in the home country whose authorities have the main responsibility for deciding and managing the intervention, even for branches established in other Member States. As a consequence, the law applicable to the proceedings, with few exception (e.g., immovable property, netting and repurchase agreements, transactions on regulated markets), is the law of the home country. Host authorities are informed of the decisions taken in the home country and shall collaborate actively to their implementation.

Finally, to complete the picture of supervisory co-operation in this area, it is useful to recall that in March 2003, banking supervisory authorities and central banks signed a MoU on crisis management. It applies to crisis situations affecting banks and banking groups with significant cross-border distribution of business which have the potential to create systemic wide disturbances. The document contains co-operation mechanisms and information-sharing procedures to facilitate the flow of information needed in a crisis situation among involved authorities. In particular, the MoU identify the home authorities as the authorities responsible for crisis management and the practical conditions for sharing information at cross-border level.

Conclusions

As stated by the G-7 Finance Ministers before the Genoa Summit\(^8\), the proper functioning of the international financial system is at the heart of a healthy global economy. The development of conditions fostering financial and economic stability is essential if the benefits of global economic integration are to be sustainable and broadly shared.

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International co-operation between supervisory authorities is justified by a clear and present need. The rapid development of cross-border financial activity puts pressure on national authorities to adapt their prudential policies. Nowadays, it would be impossible to think that a supervisory action at a purely domestic level is effective.

The contribution of international prudential co-operation to the new international economic order is not negligible. The current supervisory structures represent a firm point in the shifting landscape of financial activity. The framework described has worked effectively up to now and has contributed to building up not only sound cross-border information procedures, but also a climate of mutual confidence and trust among supervisors, which is always the condicio sine qua non to overcome difficulties that might materialize.

Therefore, this positive experience is a good basis to face the new challenges of increased competition and integration of financial markets, even though supervisors are aware of the fact that it is essential to stay open-minded vis-à-vis the increasing complexity of cross-border financial activity. A mix of experience and ability to adapt to innovation will be the right spirit to guide co-operation in years to come.

These reflections may also apply to the regulatory and supervisory governance in the European Union. In many respects, European financial markets are anticipating the integration many people would like to achieve in other sectors, and the progresses accomplished until now are a valuable contribution to the cause of the European Single Market.

As many studies reported, the robustness of EU financial governance owes much to the reliability of relations between national supervisory authorities across the Union. Both bilateral and multilateral relations have created a solid network of contacts through which it has been possible to manage the increasing cross-border activities of European financial intermediaries and to ensure stability throughout the EU.

The reform requested by the EcoFin Council is aimed at enhancing the present framework thanks to a better definition of strategies and roles among the different actors. The next few years will tell about the effectiveness of the measures proposed since many challenges will await the new framework. Enlargement will be one of the most ambitious because the inclusion of the new Members in the new governance structure will strengthen the system and ensure financial stability across the continent.
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