

**European Commission Communication on
European Financial Supervision**

Response from the City of London

15 July 2009

The City of London Corporation is an unusually diverse organisation: one of its key aims is to promote and enhance the City as a world leader in international finance and business services

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The City of London welcomes the opportunity to respond to the European Commission Communication on European financial supervision (27 May 2009). Our response takes account of the recent decisions adopted by ECOFIN on 9 June 2009 and the European Council on 18/19 June 2009.

Overview:

1. We support the broad objectives set out by the Commission: a more efficient framework for financial supervision, enhanced financial stability, greater safeguards of the interests of consumers and investors, increased competitiveness of EU financial markets and more integration of EU financial markets.
2. In creating the new structures, it is essential that policy makers remain focused on the outcomes, such as better and more consistent supervision. Key objectives must be to support open markets, to increase competition by encouraging a level playing field and to ensure as far as possible consistency of arrangements globally, regionally and locally, recognising that so many EU firms and markets, as well as their users, have a global presence.
3. Before we set out our detailed commentary and proposals for further developing the objectives of the Communication, we wish to identify several areas where we believe further clarification is required as the legislative proposals to bring effect to the new structures are developed over the summer

Clarification:

4. It is essential to be clear on the distinction between supervision and regulation. Regulation – the act of agreeing and setting new rules, together with amending existing regulation – should focus on delivering convergence towards a consistent single rule book. Supervision on the other hand, which involves the oversight of individual firms, must allow for a (high) degree of professional judgement to understand the circumstances of specific firms. That said, supervisors need to converge their supervisory practices and ensure that like firms are treated similarly.
5. In the case of “Disagreement between national supervisors” (point 4.2 (2)) it will be important to specify what sort of “diverging opinions” would be covered. The scope of “Full supervisory powers for some specific entities” (point 4.2 (4)) also needs clarification. More fundamentally still is the definition and concept of “binding cooperation” in relation to cooperation between the European Systemic Risk Board and the European System of Financial Supervisors.
6. We would also question whether it is appropriate for representatives from the European Supervisory Authorities to be present on supervisory colleges.

Detailed commentary:

More specific comments are set out below.

Macro-prudential

7. There is a clear case for the creation of a European Systemic Risk Council (ESRC) – now referred to by the European Council as the European Systemic Risk Board (ESRB) - to ensure dangers to the stability of the financial system as a whole are caught early and clear warnings are given. Of course, as the present crisis has demonstrated, monitoring the risks at the EU level is not enough. There has, as the decision recognises, to be more coordination and interaction with global entities, such as the IMF and the new FSB and close bilateral relations with new bodies (eg the new systemic risk body in the US). The ESRB's relationship with these entities needs to be clearly defined and articulated, in the spirit of cooperation and coordination, not just liaison.
8. We agree with the Commission position that the ESRB should not be able to oblige individual Member States or authorities to act, which would in any case be difficult to envisage under the Treaty. What is important is that the ESRB's warnings and recommendations should be credible and therefore listened to because of the quality of the assessment. What action follows is for ECOFIN (if the issue is further regulation), national governments, central banks and/or supervisors to decide.
9. To be credible the ESRB's membership and its voting structure needs to reflect the entire financial sector. We believe that national supervisors from all financial sectors (securities, banking and insurance) should participate in the meetings, not least those authorities overseeing the main financial and banking markets.
10. As currently proposed, voting on decisions is limited to national central banks, the three chairs of the European Supervisory Authorities and the Commission. This appears too narrow; moreover, given the Commission's role as a policymaking entity versus a regulatory body it is questionable whether it is appropriate the Commission has a vote at all.
11. In relation to the chairmanship of the ESRB, we support the recent European Council conclusions requiring this post to be elected by the General Council of the ECB, as it is important for the ESRB to be viewed and to act as an independent body for the EU as a whole, irrespective of euro-zone membership. Furthermore the ESRB should be designed such that it can raise concerns to financial stability stemming from across the whole of the EU financial system, including monetary policy, always respecting the independence of the central banks and supervisors involved.
12. The proposals for data reporting should be fully consistent with the Better Regulation principles. They should avoid an excessive burden for companies through requests for information by multiple entities and should be coordinated with national requirements. It is essential for these new processes to be carefully designed to ensure a high level of confidentiality.

Micro-prudential

13. We support the principle of promoting convergence (and harmonisation where possible) to ensure consistency of rules, however the European System of Financial Supervisors (ESFS) should not seek to overrule supervisory decisions made by national regulators which have been taken on the basis of these rules. In a complex environment different supervisory judgements are possible and may be equally valid, and may not represent a failure to interpret the rules; any regime that aims at binding mediation must recognise this fundamental starting point.
14. It will be important to define the proposed demarcation of powers between national and EU authorities. The functions of the proposed EU authorities must improve the quality of supervision, supervisory cooperation, and implementation of EU law. We support the aim of ensuring that the rules which have been agreed upon at the EU level are consistently implemented and applied but believe this is a role for the Commission not the ESFS, as already foreseen under Level 4 of the Lamfalussy structure, and ultimately for the European Court of Justice. We would support an increase in Commission resources to be targeted at this area. The peer review mechanism proposed provides a good starting point for expert assessment of where Level 4 action is required. However there is a legitimate role for the ESFS in seeking to reduce legally compliant rule variations through the means of staff exchanges, training, developing interpretative guidelines.
15. We strongly support the concept of national authorities continuing to be responsible for the authorisation and supervision of individual entities and we are concerned that the Commission's proposal departs from that concept in the case of the oversight of "EU central counterparty clearing houses". We believe that, in that regard, the Commission's proposal is undesirable and impracticable because separation of supervision of a regulated market and its CCP would run the risk of the creation of regulatory gaps or overlap and would create a dichotomy between the supervision of CCPs at European level and the underwriting of a CCP (in the albeit unlikely event of its insolvency) by the national tax payer.
16. There is a confusion of participation and accountability in relation to the ESFS and ESAs, whereby the Commission is inserted at almost every level, and yet is presented as holding these new bodies to account. This is neither logical nor desirable for the long-term governance of the new regime. As currently drafted there is also considerable scope for confusion across the definitions of EU law, binding technical standards and the application of the EU rules, together with a lack of clarity regarding the means to ensure a decision by the Authorities is made binding.
17. A single rule book should be applied when the benefits of changing existing national rules to make them identical outweigh the costs. The ESFS must put in place procedures to ensure that such tests of proportionality are applied rigorously both in relation to changes in implementation of existing Community legislation and in relation to new Directives. Single rule books can both support or impede competition and an assessment needs to be made in each case where identical rules are proposed as to whether the proposed rule promotes competition or impedes innovation.

18. At its meeting on 18/19 June, the European Council agreed that the ESFS “should have binding and proportionate decision-making powers in respect of whether supervisors are meeting their requirements under a single rule book and relevant Community law and in the case of disagreement between the home and host state supervisors, including within the college of supervisors”.
19. Any binding powers should be exercised as a last resort, only after full analysis and discussion has failed to deliver agreement; they must not interfere with specific individual supervisory decisions made in accordance with EU law.
20. We believe that there are certain criteria that this decision-making process needs to meet, for example:
 - it should be a rare event for these powers to be invoked
 - different procedures are needed to handle:
 - (a) regulatory cases where supervisors are not meeting their single rule book requirements
 - (b) supervisory cases of dispute between home/host supervisors about decisions on individual groups.
 - every effort should be made to avoid a dispute and to bring the parties to agreement before binding powers are invoked. The process needs to track the whole supervisory decision-making process so that early warnings of disagreement or concern can be discussed before views have crystallised
 - criteria should be set out to determine the extent to which this process should be public or private – it will be much easier if the process is dealt with in private.
 - there must be sensible timescales - but with an emergency mechanism
 - clarification is required to determine who has the right to launch the process and under what circumstances
21. The European Council also welcomed “the Commission’s intention to bring forward by early autumn 2009 at the latest, the legislative proposals to put in place the new framework for EU supervision”.
22. We remain concerned at the timetable envisaged for the development of these proposals as the detail of their implementation is crucial, given this is directly coupled to progress on amending existing sectoral legislation. However we recognise the pressure to deliver a workable solution to the further development of EU financial markets. The Commission should set out a detailed timetable in order to ensure that it is practicable, and takes account of the need for a considered analysis of where the allocation of decision-making powers to the EU authorities is appropriate.
23. All the changes to existing sectoral legislation should be made after formal advice has been sought by the Commission from the Level 3 committees, with full public consultation and impact assessments (i.e. under the Better Regulation agenda). The amendments to the sectoral directives should also follow an agreed common set of principles and processes, to ensure that there is order and consistency in this programme, e.g. such principles should require all the powers that are being allocated to the ESAs to be set out in an exclusive/closed (not open ended) list that makes clear precisely what can be mediated and what remains at the national level.

24. We also believe that the role of supervisory colleges should be better defined and at the very least the EU college system must be constructed with due care to dovetail with the existing global system of colleges for major cross-border groups.
25. Colleges provide a vital role as the primary vehicle for supervisory cooperation at micro-level. They therefore need clear information exchange and efficient decision-making procedures, taking into account the specific needs across the different sectors.
26. How the ESFS would work in practice needs to be carefully thought through: it should not be rushed. It will also be important to secure quality resources for the Authorities. Clarification is required as to where these resources will come from.
27. For the ESFS to be given some decision taking or mediation powers, as proposed, raises the question of the extent to which changes in existing rules or the application of new rules may have an effect on the responsibilities of governments to support their financial firms. Fiscal responsibility is an issue for finance ministries rather than the industry, but one that cannot be avoided. We therefore welcome the agreement at the June 2009 European Council that “decisions taken by the European Supervisory Authorities should not impinge in any way on the fiscal responsibilities of Member States” and recommend that further discussion is needed on the scope of this clause.

- **Relationship between the ESRB and the ESFS**

28. The relationship between the ESRB and the ESFS and its ESAs should not be seen as a hierarchy. The two bodies should have equal status, with linked but separate roles and responsibilities. The ESFS should be able to make recommendations to the ESRB as well as vice-versa.

- **Relationship between the three European Supervisory Bodies**

29. It is important to retain the streamlined cooperation of 3L3. Details will need to be developed on what happens in the case of disagreement between the three bodies and how the matter will be resolved.