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# FINANCIAL REGULATION IN THE EUROPEAN UNION

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MAPPING EU DECISION MAKING  
STRUCTURES ON FINANCIAL REGULATION  
AND SUPERVISION

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December 2008

With support from the Ford Foundation

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## ABOUT THIS REPORT

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This research document reflects a short study to provide an oversight in the main bodies and processes of decision making about financial regulation and supervision at the EU level. The document aims at providing the basis for a better insight about the influence of EU decisions regarding financial matters within Europe and in developing countries.

This paper aims to help strategic discussions by NGOs interested in undertaking advocacy on the reform of the financial system, and particularly its consequences on developing countries.

The research was undertaken between July and November 2008. It was commissioned by the European Network on Debt and Development, WEED, Bretton Woods Project and Campagna per la Riforma della Banca Mondiale.

This report has been made possible through the generous financing of the Ford Foundation which is supporting a project on Shaping European governance of global finance. Further reports and articles produced as part of this project are available at: <http://www.eurodad.org/debt/?id=2190>

This document does not aim to give a full evaluation of the European financial architecture and its impact on the developing world. However, the financial crisis that erupted in Europe in September 2008 has clearly exposed the weaknesses of the European regulatory and supervisory system, and the resulting economic crisis has affected many parts of the world.

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## ABOUT THE AUTHOR

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[http://www.tni.org/detail\\_page.phtml?&lang=en&page=fellows\\_stichele&lang\\_help=en](http://www.tni.org/detail_page.phtml?&lang=en&page=fellows_stichele&lang_help=en)

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## LIST OF ABBREVIATIONS

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CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pension Supervisors
CESR	Committee of European Securities Regulators
COREPER	Comité des représentants permanents. Normally the final committee before documents are submitted to the Council, or decides on issues on which there is consensus and no need to present to ministers. It consists of representatives from EU member countries who are permanently based in Brussels
CRD	Capital Requirements Directive
EBC	European Banking Committee
EC	European Commission
ECOFIN	Economic and Financial Affairs Council of the European Union
EFC	Economic and Finance Committee
EIB	European Investment Bank
EIOPC	European Insurance and Operational Pensions Committee
EPFSF	European Parliamentary Financial Services Forum
ESC	European Securities Committee
ESFRC	European Shadow Financial Regulatory Committee
ESCB	European System of Central Banks and its Banking Supervision Committee (BSC).
FSAP	Financial Services Action Plan
FSC	Financial Services Committee
FSF	The Financial Stability Forum
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
IIF	Institute of International Finance
IWGFC	Interim Working Group on Financial Conglomerates
UCITS	Undertakings for Collective Investment in Transferable Securities
WTO	World Trade Organisation

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## FOREWORD

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In the context of the unfolding financial crises, a debate arose about the need for concerted European Union action to mitigate the impacts and institute measures to prevent recurrence. This has been the broadest debate about European Union joint action since the establishment of the Euro zone ten years ago.

Pictures of account holders queuing outside Northern Rock banks in the UK and the unprecedented nationalisation of some large Dutch and Belgian banks moved European civil society, the media and other stakeholders to question to what extent the EU is institutionally and politically ready to face the unprecedented challenge of the financial crises.

Major European governments have been promoting a strong liberalisation and deregulation of financial markets at both European and international levels with the belief that this would strengthen European economic and monetary policies. They now recognise the problem of insufficient coordination between European supervisors and between European governments and regulators. The case of Ireland and its prompt, unilateral, move to support its financial sector is emblematic of the intrinsic competition among governments in the current European financial system which does not allow the introduction of different policies that would better support public interest and the real economy.

The coordination and concerted action by European governments have been poor despite an unprecedented number and type of meetings tested under the French Presidency. Meetings in the last four months of 2008 included the G4-European Commission meeting, the emergency European Council meeting on the crises before the G20, the common position taken by European governments at the extraordinary Washington G-20 Summit in mid-November.

The complexity of the financial regulation, decision-making processes about financial market supervision and regulation have long remained obscure to most European civil society groups. The Eurodad network together with three European NGOs active on financial markets and financial liberalisation issues for many years - WEED in Germany, CRBM in Italy and the Bretton Woods Project in the UK – commissioned this study as the first systematic effort to shed light on this complex but crucial matter. We selected Myriam van der Stichele as the expert to write the study given her work on private banks at SOMO over many years. Her findings will be of broad interest to several European civil society circles.

The report shows a fundamental lack of democracy, accountability and transparency in European decision-making processes on financial market issues. This is clearly reflected in the inadequate and biased mandate of the European Central Bank, but also in the growing number of institutionalised and informal groupings which deal with financial market issues and dominate the discourse and the formal decision-making processes.

A change in the misguided and ineffective policies promoted by European governments in financial market regulation requires a change in the European governance system in order to achieve more democracy, accountability, transparency and public participation. The financial crisis offers a unique opportunity to revise Europe's policy-making frameworks and indeed to rethink in a progressive manner the whole European integration process.

This has to be done, for the sake of European citizens' interests and rights, but also in solidarity with peoples from developing countries, who will suffer greatly from the impact of the financial crises and the associated economic recession. Our organisations are committed to explore further the

responsibilities of European governments in promoting policies and solutions to the crises which might further endanger the prospects for developing countries. We strongly appeal to European civil society networks and social actors to join forces to strategise about what should be done to transform the current European financial system into an instrument of innovative social and economic policies at regional level which will benefit the ordinary citizens, the poorest in our societies and the environment.

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Eurodad

*Peter Wahl*  
WEED

*Antonio Tricarico*  
CRBM

*Jesse Griffiths*  
Bretton Woods Project

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## SUMMARY

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At the EU level the regulation and supervision of financial markets and financial services providers remains fragmented. European member states still have diverse regulatory and supervisory cultures, for example, with regards to the role of the state. They have retained a variety of regulations and supervisory systems with competences remaining at national level with parliaments, banks or other supervisory institutions.

The fragmentation of financial regulation and supervision contrasts starkly with the expansion of the EU-wide financial markets and financial services providers. Several banks now have a presence in multiple EU countries, conducting trans-border capital transfers, and trans-border selling of highly complex and risky financial services. The EU has facilitated liberalisation of financial services providers and of financial markets. Based on the Nice Treaty and the Lisbon strategy the principles behind this liberalisation have been stronger competition in EU markets, with the purpose of reducing financing costs and improving allocation of resources, thus boosting the global competitiveness of the EU's financial industry. An effort to compete with the US financial industry, which has been dominant in some big earning sub-sectors such as investment banking, has had an important influence on EU policies.

The European Commission (EC) is the legal initiative taker (not always decision-maker) to liberalise financial services and to make them more competitive. The EC Directorate General Internal Market and Services, is in the driving seat to improve regulation and supervision of financial services at the EU level. A complex decision-making process - the Lamfalussy process - has been put in place at EU level to improve cooperation, convergence, harmonization or standardization of financial regulation and supervision. It has dealt with some important issues such as bank capital requirements, and transparency in the issuing and selling of shares and other equities.

This complex framework of sometimes overlapping committees allows member states to influence the development and adoption of EU directives on financial services and financial markets. The EC has the right to propose a directive, and the Council (ECOFIN) and the European Parliament (through the Economic and Monetary Affairs Committee) have co-decision rights to adopt the directive. Once a directive is adopted, the EC and the member states play an important role in implementation.

In the course of this complex decision-making process, the financial industry has a strong influence through its well-equipped informal lobby instruments as well as through the extensive official consultations set up by DG Markt, the Lamfalussy Committees and the European Parliament. Other stakeholders, such as consumers, have much less influence. Academics and experts in financial markets, some of whom have grouped together, have had their warnings ignored by the political decision-makers.

The European Central Bank (ECB) has no legal mandate to regulate or supervise banks and other financial actors, or financial markets. Part of the ECB's mandate is to preserve financial stability and it has been active during the financial crisis since August 2007 based on its competence to provide liquidity to the EU financial markets. The ECB is involved in many EU structures and institutions in an advisory function and is legally mandated to provide information in support of action on financial stability.

The slow, faulty and diverse implementation and application of EU legislation by EU member states has many causes. The costs of regulation and supervision were considered high and a risk to the competitiveness of EU member states' domestic finance industry. Some EU member states are home



to many cross-border financial services providers. Others, which only host them, feared losing control over their financial industry and markets and their ability to defend their interests against large European financial conglomerates. National supervisors cannot deal sufficiently with cross-border banks and conglomerates and no EU wide supervisory structure was put in place, with a reliance only on voluntary cooperation agreements.

During the financial turmoil and government interventions of September and early October 2008, the weakness of this voluntary coordination structure became clear. Many governments first took national measures before gradually coordinating response from the ECOFIN meeting of 7 October 2008 onwards. Important agreed principles were not respected, such as: managing a cross border financial crisis in a way that takes account of the interest of other countries, sharing potential fiscal burdens, and coordinating public communications to the maximum extent possible. In addition, structures for a financial crisis resolution (e.g. clear legislation dealing with the liquidation of cross-border European banks and their securitization instruments) were not in place.

In summary the existing structures did not function to prevent the crash. On the contrary, as the main tendency of the EU's financial policy was to increase liberalisation, it contributed to the depth and impact of the crisis.

The financial crisis is having severe impacts in Europe and also beyond. Developing countries are suffering from a shortage of credit and reduced exports. The European banks that are operating in developing countries also pose a stability risk. In bilateral and multilateral free trade negotiations the EU has been pushing developing countries to open up their financial sector to the European financial industry without guaranteeing effective regulation and supervision.

The EU and its member states are well represented in international financial institutions and fora. However, EU common positioning and intervention are fragmented and some member states are excluded. Developing countries have to address several governments and EU institutions to influence the European position.

The financial and economic crises are yielding a major public debate about changes in policy and in institutional arrangements. This should lead to a change in attitude and new and better structures being put in place.

# CHAPTER 1: EUROPEAN INSTITUTIONS MANDATES ON FINANCIAL REGULATION AND SUPERVISION

This chapter describes the official competences and decision-making processes of the different EU bodies involved in regulatory and supervisory measures regarding financial markets and financial services in the EU.

## 1.1. THE ROLE OF THE EUROPEAN COMMISSION

The European Commission (EC) plays a leading role in dealing with the financial sector at the EU level, by organising the EU wide operation of the financial sector and having the right to initiate financial regulation in many but not all financial services areas.

The Treaty of Nice deals specifically with financial services liberalisation. Article 51 stipulates that: “the liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the liberalisation of movement of capital.” Article 53 prohibits all restrictions on payments (current account capital movements) between Member States and between Member States and third countries. Not all capital movements related to the capital account are being liberalised immediately. Countries can still take measures for the prudential supervision of financial institutions (Art. 58) and impose restrictions on capital movements with third countries in exceptional circumstances (Art. 59-60).

The general mandate to liberalise financial services and capital movements is derived from Article 2 which gives the Community the task of establishing a common market, an economic and monetary union, convergence of economic performance and a high degree of competitiveness. At the same time, the Community should promote a high level of protection, improvement of the quality of the environment, economic and social cohesion and solidarity among Member States as well as raise the standard of living and quality of life.

General Treaty articles specify how liberalisation of financial services and capital movements, and the creation of a common market in financial services, are to be organised. According to Article 3:

- obstacles to the free movement of goods, persons, services and capital between Member States must be abolished
- competition in the internal market may not be distorted;
- laws of Member States are to be ‘approximated’ where required for the functioning of the common market;
- the competitiveness of Community industry needs to be strengthened;
- overseas countries and territories need to be associated in order to increase trade and promote jointly economic and social development.

According to Article 4 the underpinning principles are: an open market economy with free competition, stable prices, sound public finances and monetary conditions and a sustainable balance of payments.

The decision-making procedure to liberalise a specific service laid down in Article 52 stipulates that the Council shall, on a proposal from the Commission and after consulting the Economic and Social Committee and the European Parliament, issue directives acting by a qualified majority. The decision making in practice on regulating financial services as part of making the liberalised financial services

sector competitive and effective, is that the Commission initiates a directive on which both the Council of Ministers and the European Parliament have co-decision making powers. How this works in practice is explained below.

The Commission is still completing the creation of the Single Market in services and is in addition implementing the Lisbon strategy to remove cross-border barriers to services and improve the competitiveness of the EU's industries and services worldwide. The creation of a single market for financial services is seen as a way to increase efficiency, economic growth, job creation, innovation and better services and savings for consumers. In practice, this has been interpreted as implementing policies that allow or even encourage large financial conglomerates to operate across borders in the EU, for instance on the basis of mutual recognition, allowing banks established in one country to operate in another with a so-called "single passport".

#### 1.1.1. THE IMPORTANCE OF INTERNAL MARKET AND SERVICES DIRECTORATE GENERAL

Within the Commission, it is Directorate General Internal Market and Services, commonly abbreviated as "DG Markt", that has been responsible for implementing the Treaty mandate regarding financial services and capital movements, and the freedom of establishment. Note that establishment, i.e. foreign direct investment, is often needed to provide financial services in other countries or to operate in other financial markets.

DG Markt deals with the many financial sub-sectors and related issues, which are being dealt with in the different directorates and units of the DG Markt (see Box 1 which gives an overview of the different sub-sectors).

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#### **BOX 1: OPERATIONAL INFORMATION ON DG INTERNAL MARKET AND SERVICES / DG MARKT<sup>1</sup>**

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Political authority and head: Commissioner Charlie Mc Creevy (IRL), with Jean-Claude Thebault as principal Adviser (detached to the President's Cabinet)  
Director General: Jörgen Holmquist (Sweden),  
Staff: approximately 500<sup>2</sup>

Directorate F is directed by Pierre Delsaux and is responsible for free movement of capital and financial integration, company law, corporate governance, financial crime, accounting and auditing

Directorate G is directed by Emil Paulis and is responsible for :

- (G1) financial services policy, directed by Martin Merlin
- (G2) financial markets, directed by Mario Nava

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<sup>1</sup> Information updated until 1 10 2008; for more details see: <[http://ec.europa.eu/dgs/internal\\_market/departments\\_en.htm](http://ec.europa.eu/dgs/internal_market/departments_en.htm)>.

<sup>2</sup> <[http://ec.europa.eu/dgs/internal\\_market/index\\_en.htm](http://ec.europa.eu/dgs/internal_market/index_en.htm)>

(G3) securities markets, directed by Maria Velenta  
(G4) asset management, directed by Niall Bohan

Directorate H is directed by Elemér Tertak, and is responsible for financial institutions, such as:

(H1) Banking and Financial conglomerates, directed by Patrick Pearson and Arvind Wadhera

(H2) Insurance and pensions, directed by Karel Van Hulle

(H3) Retail financial services, consumer policy and payment systems, directed by Jean-Yves Muylle and Eric Ducoulombier.

## ACTION PLANS ON FINANCIAL SERVICES

The liberalisation of financial services and financial markets was not realised through the services directive (the so-called Bolkenstein Directive) but through the Financial Services Action Plan (FSAP), first between 1999 and 2005. This plan was drawn up at the request of the European Council (December 1998) based on a consensus that had been reached on a framework for action.

The FSAP indicated three following strategic objectives:

- 1. Establishing a single market in wholesale financial services;**
- 2. Making retail markets open and secure;**
- 3. Strengthening the rules on prudential supervision.**

The priorities and measures to achieve covered under each of these three objectives are the following<sup>3</sup>:

- 1. Establishing a single market in wholesale financial services**, which included:
  - Establishing a common legal framework for integrated cross border securities and derivatives markets, including dealing with market manipulation.
  - Reducing the costs and outstanding barriers to raising capital on an EU-wide basis which means dealing with standardization/harmonisation of EU wide initial public offerings (share issues), accounting standards and company law.
  - Creating a coherent legal framework for supplementary pension funds; including prudential supervision of pension funds.
  - Providing legal certainty to cross-border securities trading through the enforceability of cross-border collateral.
  - Creating a secure and transparent environment for cross-border takeover bids.
- 2. Making retail markets open and secure** by:
  - Information and transparency for consumers in the cross-border provision of retail financial services.
  - Strengthening cross border retail financial services including through redress procedures and judicial settlement of disputes for clients.
  - Harmonizing consumer protection rules for specific financial products and insurance intermediaries.

<sup>3</sup> Own summary of information provided by the EC on : <http://europa.eu/scadplus/leg/en/lvb/l24210.htm>

- Reducing the cost of cross-border retail payments.

3. **Strengthening the rules on prudential supervision** to keep pace with new sources of financial risk given the changing market realities, such as increasingly **EU wide and cross-sectoral financial industry**, through:

- Bringing banking, insurance and securities prudential legislation up to the highest standards.
- State-of-the-art supervisory practice in order to contain systemic or institutional risk (e.g. capital adequacy, solvency margins for insurance companies).
- Setting up prudential supervision of financial conglomerates.

A timetable was established to implement this Action Plan by, among others, developing, adopting and implementing new EU directives on the above mentioned issues (see also below: chapter IV). The procedures for adopting these directives, as well as the ex-ante and ex-post processes, are explained below.

The Financial Services Action Plan was replaced by the White Paper on Financial Services which set out the Commission's objectives from 2005 to 2010, namely creating "the best financial framework in the world" in order to lower capital costs, make retail financial products cheaper and improve pensions.<sup>4</sup> "Completing the Single Market in financial services is more and more recognised as one of the key areas for EU's future growth and jobs, essential for EU's global competitiveness and thus a crucial part of the Lisbon economic reform process."<sup>5</sup>

The White Paper sets the following priorities:<sup>6</sup>

- (1) Strengthening the achievements made under the FSAP, ensuring sound implementation and enforcement of existing rules, and taking new initiatives in a few targeted areas only;
- (2) Making the regulatory framework free of inconsistencies and legal ambiguities through better regulation principles;
- (3) Enhancing convergence of supervisory practices, and improving the supervisory architecture;
- (4) Creating more competition between financial service providers, especially those active in retail markets which service the average EU citizen (e.g. savings, mortgages, insurance and pensions);
- (5) Expanding EU's external influence in globalising capital markets.

In general, DG Markt<sup>7</sup> wants to ensure coherence and consistency between the various related policies such as banking, retail financial services, insurance securities, investment funds, financial market infrastructure and payments systems. The development and application of EU banking and financial conglomerates legislation has been a key policy of DG Markt.

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<sup>4</sup> EU financial services policy for the next five years, EU press (ref. IP/05/1529), 5 December 2005,

<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/05/1529&format=HTML&aged=0&language=EN&guiLanguage=en>>

<sup>5</sup> EU financial services policy for the next five years, EU press (ref. IP/05/1529), 5 December 2005,

<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/05/1529&format=HTML&aged=0&language=EN&guiLanguage=en>>

<sup>6</sup> Own summary based on : EU financial services policy for the next five years, EU press (ref. IP/05/1529), 5 December 2005,

<<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/05/1529&format=HTML&aged=0&language=EN&guiLanguage=en>>

<sup>7</sup> [http://ec.europa.eu/internal\\_market/finances/index\\_en.htm](http://ec.europa.eu/internal_market/finances/index_en.htm)

## DECISION-MAKING PROCEDURES AND RESPONSIBILITIES

DG Markt is responsible for developing the European legal framework in financial services and even has the right of initiative to propose directives. DG Markt is also responsible for analysing progress made in EU financial integration, which it does through the annual Financial Integration Reports. This includes monitoring increased competition of EU financial markets as well as potential financial instability being transmitted across borders.<sup>8</sup>

More coordination and convergence or harmonization of financial regulation and supervision at EU level has been integrated into policies to make financial liberalisation more efficient and stable while providing protection to consumers. This has implied moving away from national regulation and supervision of the financial sector, as well as a need for correct and timely transposition of European legislation at national levels, including procedures to deal with violation thereof.

Because financial supervision is still a member state mandate, and EU financial regulation is co-decided by the Council of Ministers, the member states and their supervisors have been brought in through the so-called Lamfalussy<sup>9</sup> framework. The Lamfalussy framework involves a structure in which member states, their supervisors as well as companies<sup>10</sup> are consulted when the EC designs EU banking, insurance and securities legislation (directives) and provide useful interpretative guidance. The Lamfalussy process intends to enhance the consistent and swift implementation of EU directives at EU member state level, and help them to adapt over time.<sup>11</sup>

The Lamfalussy framework has 4 levels that deal with the processes from design and adoption of legislation up to implementation by member states. It covers different Committees, and their working groups, in which member states representatives and supervisors are consulted at the different levels (see Box 2). Not all issues and regulatory measures have to be submitted to the Lamfalussy process, such as regulatory measures regarding consumer credit.

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<sup>8</sup> [http://ec.europa.eu/internal\\_market/finances/index\\_en.htm](http://ec.europa.eu/internal_market/finances/index_en.htm)

<sup>9</sup> Alexandre Lamfalussy had key functions as a central banker at international level (Bank for International Settlements in Basel) and European level (as founding president of the European Monetary Institute in Frankfurt, forerunner to the European Central Bank). From 2000 to 2001, he chaired the EU's Committee of Wise Men on the Regulation of European Securities Markets. The Committee's proposals and approach to financial service industry regulation lead to the Lamfalussy process. an approach to the development of financial service industry regulation used most famously in MiFID - the Markets in Financial Instruments Directive. For information see among others: <[http://en.wikipedia.org/wiki/Alexandre\\_Lamfalussy](http://en.wikipedia.org/wiki/Alexandre_Lamfalussy)>

<sup>10</sup> See for instance: N. Véron, Is Europe ready for a major banking crisis?, Bruegel policy brief, Issue 2007/03, August 2007, [http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066); Interview MEP I. van den Burg.

<sup>11</sup> See for instance: N. Véron, Is Europe ready for a major banking crisis?, Bruegel policy brief, Issue 2007/03, August 2007, [http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066); Interview MEP I. van den Burg.

**BOX 2: ORGANISATIONAL STRUCTURE OF ADVISORY BODIES WITH MEMBER STATE REPRESENTATIVES, IN THE LAMFALUSSY PROCESS<sup>12</sup>**

	<b>Banking</b>	<b>Insurance and Occupational Pensions</b>	<b>Securities (including UCITS<sup>13</sup>)</b>
<b>Regulatory committee</b> (Level 2 Committees)	European Banking Committee (EBC)	European Insurance and Operational Pensions Committee (EIOPC)	European Securities Committee (ESC)
<b>Committee of Supervisors</b> (Level 3 Committees)	Committee of European Banking Supervisors (CEBS)	Committee of European Insurance and Occupational Pension Supervisors (CEIOPS)	Committee of European Securities Regulators (CESR)

The Lamfalussy process can be summarised as follows<sup>14</sup>:

Level 1 develops and adopts financial framework legislation (directives) setting out the core principles defining implementing powers, without technical details as required by EU regulation disciplines. The financial framework legislation is adopted by co-decision by the Council and the European Parliament and after a full and inclusive consultation process, including with the regulatory committees and committees of supervisors (see Box 2).

Level 2 sets implementing measures with technical details following the adoption of financial directives. The 'Level 2' committees deal with political problems of directive design and implementation. The Commission is advised on the technical preparation of the implementing measures by the relevant 'Level 3' committees.

The technical implementation measure is adopted by the Commission after a vote of the competent 'Level 2' regulatory Committee (the European Securities Committee, the European Banking Committee or the European Insurance and Occupational Pensions Committee). Technical implementation measures can be taken through EU regulations, which are directly applicable in member states and addressed to every one.

Level 3 provides technical advice for implementation at national level and deals with 'transposition' of directives and Level 2 measures. The aim is to ensure common and uniform implementation by using, amongst others, common interpretative guidelines, which are non-binding.

Level 3 also aims to secure more effective cooperation between national supervisors and the convergence of supervisory practices. The Committee of European Banking Supervisors not only promotes convergence of supervision, through peer review and exchange of information or expertise, but also undertakes mediation between cross-border banks and host supervisors. It also

<sup>12</sup> Financial services: Commission presents measures to improve regulation of banking, insurance and investment funds, EU press (IP/03/1507), 6 November 2003, <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/03/1507&format=HTML&aged=0&language=EN&guiLanguage=en>>

<sup>13</sup> 'Undertakings for Collective Investment in Transferable Securities' according to [http://en.wikipedia.org/wiki/Undertakings\\_for\\_Collective\\_Investments\\_in\\_Transferable\\_Securities](http://en.wikipedia.org/wiki/Undertakings_for_Collective_Investments_in_Transferable_Securities)

<sup>14</sup> Based on different sources, amongst others: Review of the Lamfalussy process Strengthening supervisory convergence - Communication from the Commission, (COM(2007) 727 final), 20 November 2007.

prepares notes and report to the Financial Services Committee and the Economic and Financial Committee of the Council.<sup>15</sup>

Level 3 processes and activities are done at the 'Level 3' committees and their working groups, which bring together supervisors and relevant agencies. Level 3 committees and supervisors contribute the EU framework for crisis management.

Level 4 relates to the timely and correct transposition of EU legislation into national law and supervisory practices at the national level of the EU member states. The transposition and application of legislation has to be monitored and enforced by the Commission. Infringements can be brought before the European Court of Justice by the Commission.

The interaction between the different Committees and levels of the Lamfalussy process is discussed in chapter 2 and is represented visually in ANNEX I.

There is detailed information<sup>16</sup> about the membership and chairs, decision-making and voting rights, activities and working groups, the impacts and effectiveness of each of the 'Level 2' committees and 'Level 3' committees.

In 2006, the Commission set up an Interim Working Committee on financial conglomerates<sup>17</sup> and different consultative processes to review the Financial Conglomerates Directive (dating from 2002). The working group is a sub-group of the Level 3 committees in banking (CEBS) and insurance (CEIOPS) and reports back through these committees. It is part of a process that aims to improve supervision of cross-border financial conglomerates.

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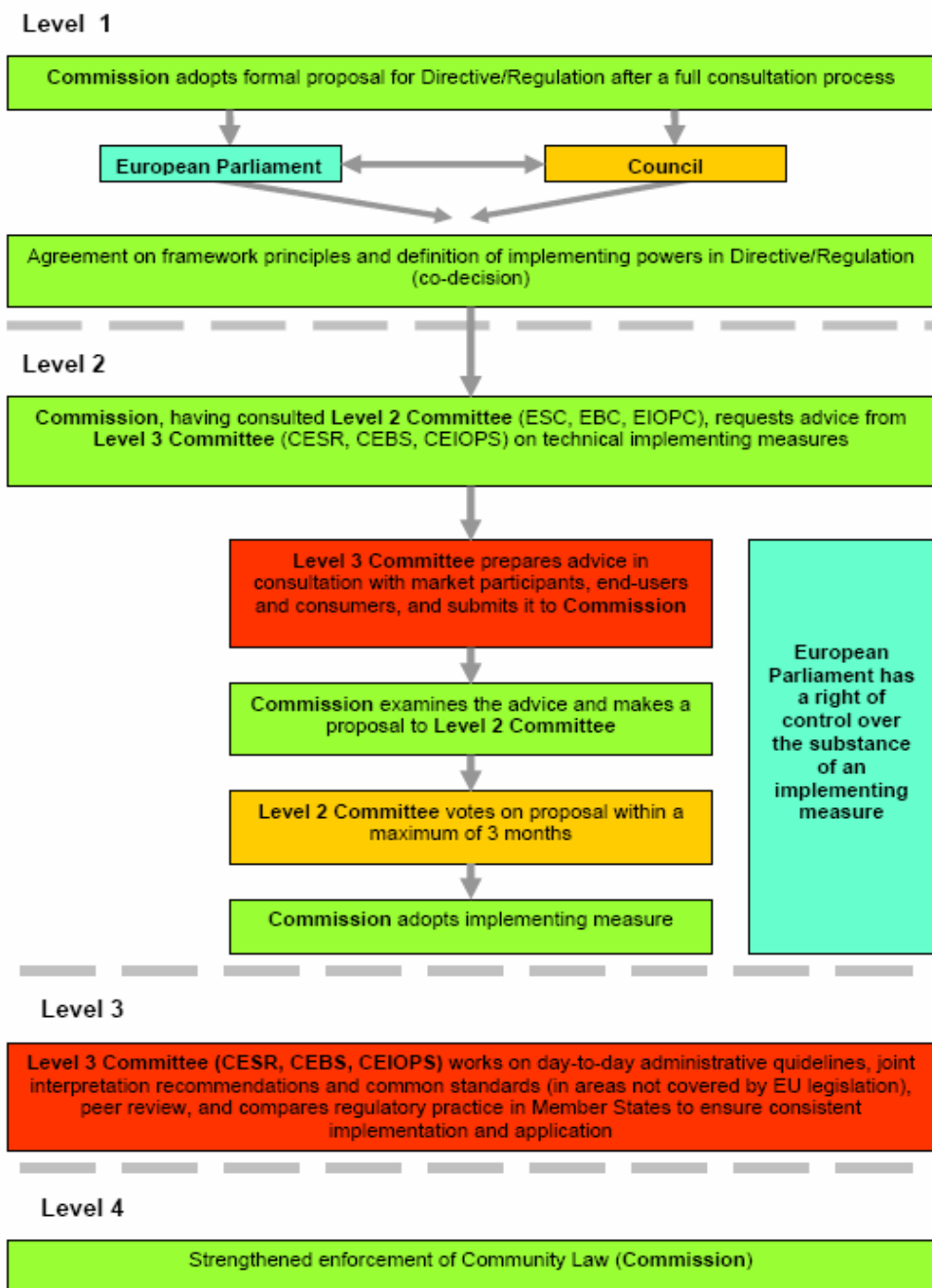
<sup>15</sup> L. Quaglia, "Financial Sector Committee Governance in the European Union", in *European Integration*, Vol. 30, Nr. 4, September 2008, p. 567. These Committees are explained below.

<sup>16</sup> See for instance: Review of the Lamfalussy process Strengthening supervisory convergence - Communication from the Commission, (COM(2007) 727 final), 20 November 2007; Inter-institutional Monitoring Group, Final report monitoring the Lamfalussy process, 15 October 2007; L. Quaglia, Art. "Financial sector committee governance in the European Union", *European Integration*, Vol. 30 nr. 4, September 2008, p. 563-578.

<sup>17</sup> For more information see a.o.:< [http://ec.europa.eu/internal\\_market/financial-conglomerates/index\\_en.htm](http://ec.europa.eu/internal_market/financial-conglomerates/index_en.htm)>



## THE LAMFALUSSY PROCESS



SOURCE: REVIEW OF THE LAMFALUSSY PROCESS, STRENGTHENING SUPERVISORY CONVERGENCE - COMMUNICATION FROM THE COMMISSION, (COM(2007) 727 FINAL).

## REVIEW PROCESSES

Many processes are being initiated by DG Markt and others, to improve the Lamfalussy framework and review its functioning. The proposals result from a general lack of satisfaction with the practical implementation of EU legislation at member state level, the loose supervisory architecture at EU level, and the weak EU framework on financial crisis management. There is an awareness that the EU regulatory and supervisory processes and structures were ill-suited to keep up with the swift expansion of financial markets and the financial industry, innovative products and increasing cross-border activities.

The financial crisis that hit the European financial system at the end of September 2008 has brought to the open and confirmed these weaknesses and is speeding up some decision-making. Some feared that the financial crisis would undermine or even destroy any cooperation in financial crisis management at EU level.<sup>18</sup> However, the review process has been sped up by the creation in October 2008 of a High Level Group on Cross-border Financial Supervision. Chaired by Jacques de Larosière, this group of experts is charged with making proposals on banking supervision, meeting the challenge of supervising cross-border banks and ensuring that “financial markets are suited to the realities of the single market”.<sup>19</sup>

## 1.2. THE EC AND COMPETITION ISSUES

### 1.2.1. DEALING WITH CONCENTRATION TO A CERTAIN EXTENT

One of the mandates of the Directorate General for competition policy (DG Competition) is to deal with international mergers and acquisitions and prevent companies distorting competition in their markets. DG Competition has to approve financial company mergers or acquisitions that affect more than one EU country, as was for instance the case when Fortis acquired ABN Amro. In that case DG Competition ordered a sell off of some parts of the merged company to avoid a dominant position on the Dutch market. Forced selling on the financial markets contributed to Fortis losses and a crisis of confidence in Fortis’ financial capacity by investors and savers.

In another case, DG Competition applied its mandate to avoid companies distorting competition by concentrating the settlement and clearing services industries. This concentration was giving enormous market power to the companies involved.

Although DG Competition has experienced staff on the issue of the financial sector, it does not have the means to deal with concentration in the financial (sub-)sector(s).

DG Competition in principle and in practice lacks the mandate to prevent banks and other financial service providers from becoming too big to fail or too interconnected to fail. Within the

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<sup>18</sup> T. Barber, “Stumbling to stability”, Financial Times, 20 November 2008, <[http://ft.onet.pl/0,17461,stumbling\\_to\\_stability,artykul\\_ft.html](http://ft.onet.pl/0,17461,stumbling_to_stability,artykul_ft.html)>

<sup>19</sup> “Jacques de Larosière, Chairman of the High Level Group on Cross-border Financial Supervision, visits EC President, José Manuel BARROSO, [news reporting], 22 October 2008, <<http://ec.europa.eu/avservices/services/showShotlist.do?out=PDF&lg=En&filmRef=59667>>

EU, there are no instruments or political decisions to prevent financial actors to become too big to fail.

Because the member states have to deal with mergers and acquisitions (M&A) in the banking, insurance and securities sectors which only relate to the national level, the EC presented in September 2006 a proposal to give guidance to supervisory approval process for such M&A. The EC wished to tighten the procedures, for instance on how authorities should assess whether or not to block proposed M&A.<sup>20</sup> By September 2007, the directive 2007/44/EC regarding procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector, was co-adopted by the European Parliament and Council. The implementation at member state level was to be effective by March 2009.

It is important to note that the situation and mandate of the DG Competition is undemocratic because the DG Competition is law-maker with hardly any control by for instance the European Parliament. DG Competition is seen as judge and public prosecutor.

### 1.2.2. DG COMPETITION AND STATE AID IN TIMES OF FINANCIAL CRISIS

DG Competition is also responsible for implementation and enforcement of Art. 87-88 of Treaty of Nice related to avoiding state aid that distorts competition. When EU member state governments started to buy up and take over different financial services providers, such as in Belgium, the Netherlands, the UK, or provided large sums of money to assist ailing banks, e.g. in Spain, DG Competition was warning that it would scrutinize whether these activities would not be against Art. 87-88 of Treaty on state aid. In some cases DG Competition has been arguing that the provided state aid was just within the limits of what was possible. Indeed, Article 87 allows state aid to redress damages from natural disasters or “exceptional occurrences”: the latter could be considered a financial crisis. However, interventions by DG Competition against state aid have been criticised by some member states.

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<sup>20</sup> “Financial sector: Commission acts to improve supervisory approval process for mergers and acquisitions “, EC Press release (IP/06/1174), 12 September 2006, <<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/06/1174&format=HTML&aged=0&language=EN&guiLanguage=en>>; it was not clear from the website how far the proposed regulation was adopted, see [http://ec.europa.eu/internal\\_market/finances/cross-sector/index\\_en.htm#obstacles](http://ec.europa.eu/internal_market/finances/cross-sector/index_en.htm#obstacles)

## 1.3. THE ROLE OF THE COUNCIL OF THE EUROPEAN UNION REGARDING FINANCIAL REGULATION AND STABILITY

### 1.3.1. THE ECONOMIC AND FINANCIAL AFFAIRS COUNCIL

The Economic and Financial Affairs Council, or ECOFIN, is composed of the Economics and Finance Ministers of the Member States.<sup>21</sup> ECOFIN meetings discussing financial services and financial markets, financial stability and movement of capital, are attended mostly by Ministers of Finance. Ministers of the 15 countries that have introduced the Euro meet informally and separately in the Eurogroup, mostly just before the ECOFIN meetings. This group is chaired by Mr Jean-Claude Juncker and discusses, among others issues, the Economic and Monetary Union (EMU).<sup>22</sup> These meetings are not part of ECOFIN. As monetary policy and economic convergence matters are beyond the scope of this paper, Eurogroup meetings are not covered in this research.

ECOFIN meets once a month. One informal ECOFIN meeting with Ministers and governors of central banks is held every six months per rotating presidency. Relevant Commissioners and the President of the ECB, as well as the chairman of the Economic and Financial Committee (see below) and the chairman of the Economic Policy Committee attend the meetings, and sometimes the President of the European Investment Bank.

ECOFIN has co-decision powers, with the European Parliament, to decide on directives proposed by DG Markt related to financial services and financial markets. Decisions are made by qualified majority, i.e. a majority of Member States needs to approve (see also ANNEX IV).<sup>23</sup> France, Germany, Italy and the UK have together around one third of the votes.

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<sup>21</sup> The overall mandate of ECOFIN is to deal with among others: “economic policy coordination, economic surveillance, monitoring of Member States’ budgetary policy and public finances, the euro (legal, practical and international aspects), financial markets and capital movements and economic relations with third countries” <[http://consilium.europa.eu/cms3\\_fo/showPage.asp?id=250&lang=en](http://consilium.europa.eu/cms3_fo/showPage.asp?id=250&lang=en)>

<sup>22</sup> [http://consilium.europa.eu/cms3\\_fo/showPage.asp?id=250&lang=en](http://consilium.europa.eu/cms3_fo/showPage.asp?id=250&lang=en)

<sup>23</sup> [http://consilium.europa.eu/cms3\\_fo/showPage.asp?id=250&lang=en](http://consilium.europa.eu/cms3_fo/showPage.asp?id=250&lang=en)

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## VOTING AT THE COUNCIL OF MINISTERS

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The number of votes each Member State can cast is set by the Treaties.

### Distribution of votes for each Member State<sup>24</sup>

Germany, France, Italy, United Kingdom	29
Spain, Poland	27
Romania	14
Netherlands	13
Belgium, Czech Republic, Greece, Hungary, Portugal	12
Austria, Bulgaria, Sweden	10
Denmark, Ireland, Lithuania, Slovakia, Finland	7
Cyprus, Estonia, Latvia, Luxembourg, Slovenia	4
Malta	3
<b>Total</b>	<b>345</b>

Before the Commission makes a proposal for a directive, ECOFIN decides on proposals from the Commission on “roadmaps”. These road maps set time tables and deadlines for proposals and decisions to be made on new or to-be-amended directives. Areas covered include, work programmes for Level 2 and Level 3 committees of the Lamfalussy process; research and reports to be made by the Commission and others; implementation or transposition of EU legislation and their monitoring or enforcement; and the creation or modification of existing financial bodies including in the Lamfalussy process.<sup>25</sup> Important roadmaps<sup>26</sup> with timetables were decided during the ECOFIN meetings of 9 October 2007 and 14 May 2008. They set out work programmes on matters such as enhancement of deposit guarantee schemes, better cooperation among supervisors, the supervision of cross-border banks and insurance companies, improving cooperation in crisis management, clarification when state aid is allowed under EU law in case of a financial crisis and a “serious disturbance for the economy”, or changing of the directive on winding up insolvent subsidiaries of banks. Ironically, the timetable agreed during the May 2008 ECOFIN contained an EU wide crisis simulation exercise to test arrangements that had been proposed regarding cross-border financial groups. Many of the processes and matters already included in the May 2008 roadmap were accelerated and sharpened when the financial crisis erupted in Europe in September 2008, as can be seen in reports of the ECOFIN meeting from 7 October 2008 onwards and in statements by heads of government (see below).

Achieving a smooth ECOFIN decision making process has often proved difficult. Its effectiveness is hindered by the sheer number of countries involved, each with different interests in

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<sup>24</sup> Source: [http://www.consilium.europa.eu/cms3\\_fo/showPage.asp?id=242&lang=EN&mode=g](http://www.consilium.europa.eu/cms3_fo/showPage.asp?id=242&lang=EN&mode=g). The Treaties also define cases in which a simple majority, qualified majority or unanimity are required. A qualified majority will be reached if the following two conditions are met:

- if a majority of Member States approve (in some cases a two-thirds majority);
- a minimum of 255 votes is cast in favour of the proposal, out of a total of 345 votes.

In addition, a Member State may ask for confirmation that the votes in favour represent at least 62% of the total population of the Union. If this is found not to be the case, the decision will not be adopted.

<sup>25</sup> See for instance ‘roadmaps’ decided at ECOFIN of 9 October 2007 <[http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ecofin/96375.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/96375.pdf)>, and 14 May 2008 <[http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ecofin/100339.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/100339.pdf)>

<sup>26</sup> Annex to the Council decisions, ‘Financial Markets Stability Roadmaps, document (9056/1/08, REV 1; EF – ECOFIN 158) <<http://register.consilium.europa.eu/pdf/en/08/st09/st09056-re01.en08.pdf>>

the financial sector. For instance, home countries of European cross-border banks have an interest in maintaining large competitive banks (e.g. UK) while host countries are afraid that the decisions taken by European cross-border banks and their supervisors will be against their interests (e.g. in small Eastern European countries). In addition, the different cultures regarding supervision and rule-making (e.g. French style clear rules with prohibitions vs. UK rules of principle that determine what should be achieved) in each member states also make the decision making process at ECOFIN difficult. This was seen at the ECOFIN of on 7 October 2008 when the council wished to stem the crisis by taking a decision on a EU wide minimum amount for a deposit guarantee scheme (of 50,000 Euro while it was around 20,000 Euro in many countries). The Czech Minister had been opposing such government intervention complaining that after communism, he did not want to see state control again under the EU.

Before the Commission finalises a proposal and in order to prepare voting on a directive proposed by the Commission, several discussions may take place at the ECOFIN meetings and especially at the meetings of the preparatory bodies. In preparing Council meetings, normally members of the Committee of Permanent Representatives (COREPER), which is composed of EU member state representatives who are permanently based in Brussels, play an important role. COREPER is normally the final committee before documents are submitted to the Council, and decides on issues where there is consensus and no need to present them to ministers. In the case of ECOFIN, there are some special committees involved before ECOFIN meetings, which deal with the technicalities of the issues.

### 1.3.2. ECONOMIC AND FINANCIAL COMMITTEE

The Economic and Financial Committee (EFC) discusses and prepares financial market issues as well as relations with third countries and international institutions such as the IMF and the Financial Stability Forum. The EFC is considered to have significant influence over decision-making at ECOFIN since Ministers do not always have knowledge about the technical details.

One of the official mandates of the Committee (laid down in Art. 114.2.,3.,4. of the Treaty of Nice) is to keep under review the economic and financial situation as well as the movement of capital, freedom of payments in the EU Member States and the implementation of the Financial Services Action Plan (FSAP).<sup>27</sup> It also deals with the Eurogroup<sup>28</sup> preparations. Additionally, the importance of the EFC is reflected in the mandate it is given to work in between meetings. For instance after the 7 October 2008 ECOFIN, the EU member states and the other EU authorities were to remain in daily contact through the EFC.

The EFC is an advisory committee that allows for closed policy and expert dialogue between the member states, national central banks, the Commission, and the European Central Bank. “The Committee may entrust the study of specific questions to its alternate members, to subcommittees or to working parties.”<sup>29</sup>

Each member state appoints two members, selected from among senior officials of the administration (ministerial level) and the national central bank, and must have outstanding competence in the economic and financial field.<sup>30</sup> “The Committee has a President elected by a

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<sup>27</sup> Europe – Main EU coordination mechanisms at <[http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16\\_Comite\\_economique\\_et\\_financier-GB.pdf](http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16_Comite_economique_et_financier-GB.pdf)>

<sup>28</sup> members of the Euro zone

<sup>29</sup> <http://europa.eu/scadplus/leg/en/lvb/l25038.htm>

<sup>30</sup> <http://europa.eu/scadplus/leg/en/lvb/l25038.htm>

majority of its members. The two-year term of office is renewable. The President represents the Committee, including in its relations with the European Parliament. The President's voting right is delegated to his/her alternate and, if indisposed, the President is replaced by the Vice-President of the Committee.”<sup>31</sup> The current Chairman of the EFC is Xavier Musca. The EFC is assisted by a Secretariat that comes under the Commission’s Directorate General for Economic and Financial Affairs.

Meetings are held in Brussels except for one meeting a year which is held in another EU country.<sup>32</sup> Twice a year, the EFC meets in a specific format, the “Financial Stability Table”. Its composition is then that of a full EFC, “enlarged” to include non-member participants, such as the presidents of committees that specialise in supervision of the financial sector.”<sup>33</sup>

When voting, decisions are adopted by a majority of the members. However, in case there are questions on which ECOFIN may take a decision, members from national central banks and the Commission will not participate in the vote, and the EFC will report on minority or dissenting votes.<sup>34</sup>

The functioning of this expert group has been characterised as closed and secretive with informal practices and routines.<sup>35</sup> Indeed, the Committee deliberations are confidential according to its statutes.<sup>36</sup> However the enlarged membership of the EFC since new EU members joined has had an influence on its functioning.

### 1.3.3 THE FINANCIAL SERVICES COMMITTEE (FSC)

As a sub-committee of the COREPER and Economic and Financial Committee, the Financial Services Committee was created in 2003<sup>37</sup> with the following tasks specifically regarding integration of financial services at EU level:

- assessing progress and implementation regarding financial services at the EU level,
- providing political advice and oversight on both internal issues (e.g. single market, including implementation of the Financial Services Action Plan) and external issues (e.g. WTO-GATS);
- providing cross-sectoral strategic reflection (separate from the legislative process),
- helping to define the medium and long-term strategy for financial services issues,
- considering sensitive short-term issues,

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<sup>31</sup> <http://europa.eu/scadplus/leg/en/lvb/l25038.htm>

<sup>32</sup> Europe – Main EU coordination mechanisms at <[http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16\\_Comite\\_economique\\_et\\_financier-GB.pdf](http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16_Comite_economique_et_financier-GB.pdf)>

<sup>33</sup> Europe – Main EU coordination mechanisms at <[http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16\\_Comite\\_economique\\_et\\_financier-GB.pdf](http://www.banque-france.fr/gb/eurosys/telechar/europe/04-16_Comite_economique_et_financier-GB.pdf)>

<sup>34</sup> <http://europa.eu/scadplus/leg/en/lvb/l25038.htm>

<sup>35</sup> G. Grosche & U. Puetter, Preparing the Economic and Financial Committee and the Economic Policy Committee for Enlargement, *Journal of European Integration*, Volume 30, Issue 4 September 2008, pages 527 – 543,

<<http://www.informaworld.com/smpp/content~content=a901957389~db=all~jumptype=rss>>

<sup>36</sup> <http://europa.eu/scadplus/leg/en/lvb/l25038.htm>

<sup>37</sup> Council Decision of 18 February 2003 concerning the establishment of the Financial Services Committee (2003/165/EC), <[http://www.ena.lu/council\\_decision\\_2003-165-ec\\_concerning\\_establishment\\_financial\\_services\\_committee\\_february\\_2003-020007115.html](http://www.ena.lu/council_decision_2003-165-ec_concerning_establishment_financial_services_committee_february_2003-020007115.html)>; see also : <[http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/en/misc/75677.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/misc/75677.pdf)> and <<http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/04/106&format=HTML&aged=0&language=EN&guiLanguage=en>>

The Financial Services Committee (FSC) has to report to the Economic and Financial Committee in order to prepare advice to the ECOFIN Council.<sup>38</sup> In its May 2008 conclusions the ECOFIN mentioned the FSC as one of the Committees involved in the follow-up of the Council Conclusions on the EU supervisory framework and financial stability arrangements.<sup>39</sup>

The FSC is composed of very high-level representatives of the Member States and the European Commission (DGMarkt). A representative of the European Central Bank and the chairs of the relevant (Lamfalussy) committees of regulators will have observer status, as well as each of the accession states until they become full EU members. The Committee has a chair and one vice-chair who is appointed from among the representatives of the member states.

The chairman and vice-chair, together with the representative from the Commission, the representative from the member state holding the presidency of the Council, a representative of the general secretariat of the Council and a representative from the secretariat of the Economic and Financial Committee, cooperate closely in order to facilitate the work of the Committee.

This Committee is somewhat open to scrutiny through the rule that the Chairman of the Committee shall be available for a regular exchange of views on strategic developments related to financial markets with the Committee on Economic and Monetary Affairs of the European Parliament.

## 1.4. AD HOC CRISIS MANAGEMENT BY HEADS OF GOVERNMENT

During the severe financial market turmoil in European markets that started in September 2008, the French Presidency called for informal meetings, to occur outside any pre-existing structures, in order to coordinate intervention to stabilise the financial sector. These coordination efforts started after a week when member states had acted alone and governments had given priority to their own national interests. This was clear, for example from the Irish government's full deposit protection guarantee, the Dutch government's acquisition and nationalisation of Dutch parts of Fortis (which included ex-ABN Amro parts). Member states did not abide by the Memorandum of Understanding about cooperation in times of crisis of cross border banks (see below 1.6.)

### 1.4.1. PARIS SUMMIT OF EU MEMBER STATES BELONGING TO G7

On 4 October 2008, the French president organised a meeting in Paris with other EU leaders who are part of G-7: Germany, the UK and Italy. European Central Bank President Jean-Claude Trichet and Jean-Claude Juncker, chairman and spokesman for the finance ministers of the Euro currency zone, also attended the Paris summit, as did European Commission chief Jose Manuel Barroso.<sup>40</sup>

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<sup>38</sup> Council Decision of 18 February 2003 concerning the establishment of the Financial Services Committee (2003/165/EC),

<sup>39</sup> 2866th ECONOMIC and FINANCIAL AFFAIRS Council meeting, Brussels, 14 May 2008,

<[http://www.eu2008.si/en/News\\_and\\_Documents/Council\\_Conclusions/May/0514\\_ECOFIN8.pdf](http://www.eu2008.si/en/News_and_Documents/Council_Conclusions/May/0514_ECOFIN8.pdf)>

<sup>40</sup> "European leaders offer united front on crisis", Reuters, 4 October 2008, published on <<http://www.ft.com/cms/s/0/30594642-9213-11dd-98b5-0000779fd18c.html>>



The statement of the meeting did not reveal much concrete actions but made promises for agreed principle or “doctrine”<sup>41</sup> of coordination: “Each government will operate with its own methods and means, but in a co-ordinated manner”<sup>42</sup> potential cross-border effects of national decisions are taken into consideration.”<sup>43</sup> Other principles agreed were flexibility regarding the rules on state aid and on the Stability and Growth Act, no bonuses for CEOs of failing banks, and – in the medium term - strengthened supervision of all financial players including credit rating agencies, hedge funds and investment banks. France had made a proposal for a European fund for failing banks but Germany opposed any coordinated European bail-out plan. Mr Brown was also sceptical of the need for any Europe-wide plan.<sup>44</sup>

However, the meeting failed to restore confidence in the markets since the stock markets plunged on 6 October 2008 because the response by the EU leaders, ministers, regulators and supervisors was seen as late and scattered. The wholesale money markets remained paralysed with no banks lending to each other.<sup>45</sup> The president of the European Parliament criticised this Paris summit, warning that the leaders of Europe's four largest economies have no power to decide for the entire European Union.<sup>46</sup>

The meeting called by president Sarkozy on 4 October happened just two days before the finance ministers of the Euro zone and all 27 member states were to meet at the ECOFIN meeting of 6-7 October 2008.<sup>47</sup> At that meeting, the Ministers agreed to better coordination in the areas of:

- financial stability (e.g. principles of national interventions, increasing the deposit guarantee schemes, reviewing the capital reserve requirements, change of some accountancy rules),
- financial supervision (e.g. regulating rating agencies, better cooperation of supervisors),
- executive pay (principles for national authorities to improve executive pay and shareholders’ control),
- economic slowdown as a consequence of the financial and credit crisis (e.g. better financing of small and medium sized enterprises through the European Investment Bank, structural reforms, flexibilities for state aid),
- intervention at international forums such as the Financial Stability Forum and the IMF (see chapter 5).

Many of these issues were mentioned in the roadmaps decided earlier by ECOFIN (October 2007, May 2008), and ministers agreed to continue to implement the issues covered in the roadmaps.

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<sup>41</sup> Press conference by Sarkozy, seen at <<http://news.bbc.co.uk/2/hi/europe/7648249.stm>>

<sup>42</sup> “No banks bail-out fund for Europe”, BBC NEWS, 4 October 2008, <<http://news.bbc.co.uk/go/pr/fr/-/2/hi/europe/7648249.stm>>

<sup>43</sup> Statement - Summit of European G8 members Palais de l'Elysée, 4 October 2008, published at <http://www.elysee.fr/documents/>. Author's translation.

<sup>44</sup> “No banks bail-out fund for Europe”, BBC NEWS, 4 October 2008, <<http://news.bbc.co.uk/go/pr/fr/-/2/hi/europe/7648249.stm>>

<sup>45</sup> “Financial crisis pummels stocks”, 6 October 2008, published: 18:46:18 GMT at <http://news.bbc.co.uk/go/pr/fr/-/2/hi/business/7654025.stm>: “Stock markets are falling.. and it's the troubles of Europe's banks, and the messy response of the authorities, that's to blame” (Robert Peston, BBC business editor).

<sup>46</sup> “No banks bail-out fund for Europe”, BBC NEWS, 4 October 2008, <<http://news.bbc.co.uk/go/pr/fr/-/2/hi/europe/7648249.stm>>

<sup>47</sup> 2894th Council meeting Economic and Financial Affairs on 7 October 2008, Press release, Nr: 13784/08, 8 October 2008, <[http://www.consilium.europa.eu/uedocs/cms\\_Data/docs/pressData/en/ecofin/103250.pdf](http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressData/en/ecofin/103250.pdf)>

#### 1.4.2. PARIS SUMMIT OF EU MEMBER STATES HAVING INTRODUCED THE EURO

On 12 October 2008, a summit took place of the heads of governments from the 15 countries sharing the Euro at the French Presidential Palace L'Elysée. There had been no such formal meeting since 1999 when the Euro was created. Except for Mr Brown, the UK prime minister (who was allowed to explain his plans and ideas during part of the meeting), the other 12 EU member states not part of the Eurogroup were excluded from the meeting and its decisions. However, an official summit in the form of a European Council<sup>48</sup> of head of states had been scheduled to take place on 15-16 October. This meeting of 12 October felt as being a few countries taking the lead in a smaller group and avoiding political differences that made decisions difficult as happened during the 6-7 October 2008 ECOFIN meeting. Also the Commission (President) was being sidelined by this Elysée meeting. The meeting came however after the IMF and World Bank annual meetings where it had been agreed to take concerted action to stabilise the markets.

The Euro-country Paris summit agreed on principles and actions especially to re-start inter-bank lending that had been completely frozen, for instance through guaranteeing bank lending, injecting capital and liquidity to allow for basic financial services to resume, and recapitalisation of distressed banks.<sup>49</sup>

### 1.5. THE ROLE OF THE EUROPEAN PARLIAMENT

The EP has official competence in the regulation and supervision of financial services, institutions and markets including financial reporting, auditing, accounting rules, corporate governance and other company law matters specifically concerning financial services. The Lisbon Treaty will not change the current competence of the European Parliament regarding the financial sector and competition policy.

The EP has thus legislative powers on these issues, e.g. regarding directives on capital requirements for banks. The legislative power is in the form of co-decision powers with the Council (Level 1 of Lamfalussy process) on directives proposed by the Commission. Co-decision power does not mean the right to amend. Also the EP does not have the right to propose or initiate legislation, which is the prerogative of the Commission (mostly DG Markt on these matters). The EP tries to convince the Commission to initiate some regulatory decisions, through its own initiative reports and resolutions, but the Commission can deny these resolutions<sup>50</sup>.

After a directive has been agreed, the EP has no competence in the development of the implementation measures and in the implementation itself (Levels 2 to 4 of the Lamfalussy process). However, through a special framework agreement on the relations between the EP and the Commission, the EP can have information about Level 2 matters and prevent a proposal of the EC to go forward.

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<sup>48</sup> For a quick overview of decisions taken see: < <http://crossick.blogactiv.eu/2008/10/18/eu-summit-conclusions15-16-october/>>. For more details see: <[http://ec.europa.eu/economy\\_finance/focuson/focuson13254\\_en.htm](http://ec.europa.eu/economy_finance/focuson/focuson13254_en.htm)>

<sup>49</sup> See the full declaration at: [http://www.eu2008.fr/PFUE/lang/en/accueil/PFUE-10\\_2008/PFUE-12.10.2008/sommet\\_pays\\_zone\\_euro\\_declaration\\_plan\\_action\\_concertee](http://www.eu2008.fr/PFUE/lang/en/accueil/PFUE-10_2008/PFUE-12.10.2008/sommet_pays_zone_euro_declaration_plan_action_concertee)

<sup>50</sup> MEP Ieke van den Burg (NL) was the EP rapporteur on reports on risks in the financial markets and in financial regulation and supervision (2005, 2007) which were ignored by the Commission.

The EP has no official right to intervene at 'Level 3', but may ask chairs of the Level 3 Committees to speak at the EP, and ask to see the work plans and reports of the different level 3 committees.

#### 1.5.1. ECONOMIC AND MONETARY AFFAIRS COMMITTEE OF THE EP51

The Economic and Monetary Affairs Committee (ECON) is the EP Committee that enacts the co-decision powers of the EP's competence on the regulation and supervision of financial services, institutions and markets, including company law matters specifically concerning financial services.<sup>52</sup> This committee drafts and amends the related resolutions and decisions, before they are presented to the plenary of the EP.

ECON is also responsible for the following issues although not always with legislative power:

- the economic and monetary policies of the Union, the functioning of Economic and Monetary Union and the European monetary and financial system (including relations with the relevant institutions or organisations);
- the free movement of capital and payments (cross-border payments, single payment area, balance of payments, capital movements and borrowing and lending policy, control of movements of capital originating in third countries, measures to encourage the export of the Union's capital);
- the international monetary and financial system (including relations with financial and monetary institutions and organisations);
- rules on competition and State or public aid;
- tax provisions.

The EP has no competence on (co-)deciding on what positions European institutions (Commission, ECB, the EU presidency) take in international bodies related to financial stability and the international architecture, nor can it require full accountability on these positions taken. The EP tries to know more about the positions the EU is officially taking through dialogue and discussion with the relevant officials.

The expertise of some of the ECON members is high, as can be seen in 2008 the detailed resolutions and own initiative reports with recommendations to the Commission on regulation of hedge funds and private equity, transparency of institutional investors, and the "Lamfalussy follow-up: the future structure of supervision"<sup>53</sup>. For a list of all ECON members, see ANNEX IV. However, the capacity ECON members and their assistants to deal with the matters is not considered to be sufficient, certainly not compared with US congress members -who have much more assistants- and with whom MEPs have direct contacts. The socialist MEPs have been strengthened through work done by experts for the Socialist Group in the European Parliament, which for instance produced a detailed report "Hedge funds and private equity – a critical analysis".

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<sup>51</sup> Information is mostly based on an interview with Ieke van den Burgh, MEP and active member of ECON, on 29 August 2008 <<http://www.europarl.europa.eu/activities/committees/homeCom.do?jsessionid=988BE593DD6BB8EDB591334B4FA3A97A.node1?bo dy=ECON&language=EN>> and other sources.

<sup>52</sup> N.B.: The EP Committee on Internal Market and Consumer Protection has not mandate to deal with financial services.

<sup>53</sup> See for full text: <<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P6-TA-2008-0476>>

ECON members are assisted and supported by external expertise. A panel of experts as well as a group of professors and academics/scientists support the committee and are invited as speakers. In addition, there is an official consultation mechanism with the financial industry through the European Parliamentary Financial Services Forum (see Chapter 3).

The ECON has been holding many debates on the financial crisis and has regular hearings with the president of the ECB, and even invited IMF Director General Strauss Kahn.

### 1.5.2. INTERNATIONAL TRADE COMMITTEE

The International Trade Committee (INTA)<sup>54</sup> is responsible for monitoring matters relating to liberalise financial services in trade agreements with third countries, as part of it's the mandate regarding the establishment and implementation of the EU's common commercial policy and its external economic relations, in particular:

- financial, economic and trade relations with third countries and regional organisations;
- measures of technical harmonisation or standardisation in fields covered by instruments of international law;
- relations with the relevant international organisations and with organisations promoting regional economic and commercial integration outside the Union;
- relations with the WTO, including its parliamentary dimension.
- The committee liaises with the relevant inter-parliamentary and ad hoc delegations for the economic and trade aspects of relations with third countries.

Under the Nice Treaty, the EP has no competence to (co-)decide on the mandate based on which the Commission negotiates trade agreements with third countries. The Commission informs the EP/INTA on trade negotiations and when the trade agreement covers Single Market issues, the EP has a role in ratifying the agreement.

### 1.5.3. THE EP COMMITTEE ON INTERNAL MARKET AND CONSUMER PROTECTION (IMCO)

The Committee on Internal Market and Consumer Protection (IMCO) is not responsible for the freedom to provide services in the financial sectors, but deals with protecting the consumer of financial products. In October 2008, it has for instance produced an own-initiative report improving consumer education and awareness on credit and finance.<sup>55</sup>

### 1.5.4. THE EP COMMITTEE ON LEGAL AFFAIRS (JURI)

Some aspects of financial companies and their governance are also dealt with by MEPs active in the Committee on Legal Affairs (JURI) since that Committee is responsible for company law and

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<sup>54</sup> <http://www.europarl.europa.eu/activities/committees/homeCom.do?language=EN&body=INTA>

<sup>55</sup> <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0393+0+DOC+WORD+V0//EN&language=EN>

corporate governance. In practice that means that ECON drafts a resolution or report related to financial company laws, which is then commented or amended by MEPs from JURI, or vice versa.

## 1.6. NATIONAL SUPERVISORS AND THEIR REGULATORS

Once directives and their implementation measures have been decided at the EU level, national regulators and supervisors are responsible for applying them. If implementation measures decided upon by the Commission (DG Markt) take the form of ‘regulations’, they are under EU laws directly applicable in each member state. In the fields covered by directives, a member state can only legislate to implement EU law, including providing further necessary detail and ensuring proper enforcement, e.g. by adding sanctions for non-compliance. A member state may go further than EU law only where permissible under a directive and when not contradicting EU law. The EU does not have competence over all financial regulations, e.g. regulation of mortgage lending.<sup>56</sup>

The competence for all financial supervision remains at the level of EU member states, while the EU has been liberalising financial services across the EU. The Treaty does not provide legislative competence at the European level on how the supervisory function should be organised at national level.<sup>57</sup>

Several agreements, instruments and dialogue structures have been set up as explained above to coordinate supervision among national authorities (see throughout this report, especially the Lamfalussy Level 3 Committees). Because of the lack of an EU mandate, such coordination remains voluntary, even regarding the supervision of banks with cross-border activities. This voluntary coordination is now being organised through agreements on non-binding memoranda of understanding for cooperation.

One analyst described it as follows: “to improve cross-border cooperation between existing national agencies, an extensive network of bilateral ‘memorandums of understanding’ (MoUs) has been built since the late 1980s, complemented more recently with multilateral MoUs on information sharing during a crisis and on specific banking groups. But the interlocking of many national sources of authority has also created complexity and blurred the lines of responsibility for supervision and crisis management. The MoUs are non-binding, and their effectiveness has yet to be tested by a crisis.”<sup>58</sup>

Since 1st June 2008 there has been a voluntary Memorandum of Understanding on cooperation between the financial supervisory authorities, central banks and finance ministries of the European Union – on cross border financial stability.<sup>59</sup> This MoU was signed by 118 institutions in 27 EU member states and by the ECB. It is not legally binding. This EU wide MoU contains common principles as well as practical arrangements for involving all relevant national institutions in case of

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<sup>56</sup> Ian Pearson (UK) Economic Secretary to the Treasury, answer to written question asked by Ann Winterton MP "whether financial services regulation is an exclusive competence of the European Union", 31 October 2008, <<http://eureferendum.blogspot.com/2008/10/who-are-masters-now.html>>

<sup>57</sup> Inter-institutional Monitoring Group, Final report monitoring the Lamfalussy process, 15 October 2007.

<sup>58</sup> N. Véron, Is Europe ready for a major banking crisis?, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>59</sup> For the full text see:

[http://www.cnb.cz/m2export/sites/www.cnb.cz/cs/verejnost/pro\\_media/tiskove\\_zpravy\\_cnb/2008/080618\\_MoU.pdf](http://www.cnb.cz/m2export/sites/www.cnb.cz/cs/verejnost/pro_media/tiskove_zpravy_cnb/2008/080618_MoU.pdf)

cross border financial crisis, while still respecting the legal responsibilities of competent authorities.<sup>60</sup> The principles of the EU wide MoU include: the primacy of private solutions, managing a cross border financial crisis in a way that takes account of the interest of other countries, a sharing of potential fiscal burdens are being prepared in normal times, and coordination of public communications to the maximum extent possible. The implementation of this MoU is to be monitored by the Economic and Financial Committee (see above under ECOFIN). It should be noted that during the financial turmoil and government interventions of September and early October 2008, the weakness of this voluntary coordination structure became clear since many governments first took national measures before gradually taking a more coordinated response since the ECOFIN meeting of 7 October 2008.

Some see the slow and inconsistent national level implementation of EU financial directives unsatisfactory and a bottleneck in the whole regulatory and supervisory financial architecture of the EU (see Chapter 2). Others point to the shortcomings and shortage of EU directives and EU processes, which are not capable of avoiding a financial and economic crisis.

Because the European expansion of cross-border banks, insurance companies and other financial operators was facilitated by the EU while supervision remained fragmented without sufficient coordination and exchange of information, many calls<sup>61</sup> have been made to at least coordinate among the home and host country supervisors of each EU cross-border financial services provider, e.g. through “colleges of supervisors”.<sup>62</sup> Although there is so far no legal mandate, nor political will, to create an EU wide single supervisory instrument, there are attempts to come to more coordination in order to supervise cross-border banks, insurance companies and other financial services. Discussions have been held at different levels in the EU (EC, European Parliament, Council). However, host countries fear losing control, becoming unable to defend their interests if the home country supervisor takes the lead and takes the final decisions. In October, the Commission created the High Level Group on cross-border financial supervision to find solutions to the issue, chaired by Jaques de Larosière (see chapter 4, 4.2.).

## 1.7. THE ROLE OF THE EUROPEAN CENTRAL BANK

*The ECB “has no supervisory mandate and, apart from its responsibility for open-market operations, its only financial stability task is a monitoring role, supported by the ECB’s Banking Supervision Committee.”<sup>63</sup>*

*“The ambiguous role of the ECB in financial stability oversight has not been formally clarified, but informally the bank is in the driver’s seat.”<sup>64</sup>*

This research report does not cover one of the central tasks of the ECB, namely to manage the Euro and safeguard price stability within the Eurozone, and to frame and implement the EU’s economic and monetary policy. This research looks at the role of the ECB in stability of the financial markets, and regulation and supervision of the financial industry.

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<sup>60</sup> [http://www.cnb.cz/en/public/media\\_service/press\\_releases\\_cnb/2008/080618\\_MoU\\_en.html](http://www.cnb.cz/en/public/media_service/press_releases_cnb/2008/080618_MoU_en.html)

<sup>61</sup> See for instance N, Véron, “All together now”, Wall Street Journal Europe, 3 October 2008.

<sup>62</sup> See for instance N, Véron, *ibidem*.

<sup>63</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>64</sup> K. Lannoo, “The crisis, one year on”, CEPS Commentary, 7 August 2008, <[http://shop.ceps.eu/BookDetail.php?item\\_id=1690](http://shop.ceps.eu/BookDetail.php?item_id=1690)>

The mandate, the functioning and operation of the ECB, established in 1998, is closely linked and often merged with that of the European System of Central Banks (ESCB), as laid down in the Treaty of Nice (e.g. Art. 8, Art. 105-124) and the Protocol on The Statute of The European System of Central Banks and of the European Central Bank. The ESCB is composed of the ECB and of the central banks of all the EU member states. The General Council is the ECB's third decision-making body<sup>65</sup>. It comprises the ECB's President and the Vice-President and the governors of the national central banks of all 27 EU member states.<sup>66</sup> The ECB and ESCB are to act independently without political interference or accountability, but "in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4 of this Treaty." (Protocol, Art. 2)

Unlike several national central banks, the ECB does not have a mandate to supervise banks, other financial services providers or financial markets. The main mandate of the ECB and ESCB is laid down in Article 105.2 of the Treaty of Nice some of which is in practice related to financial market stability such as the mandate to deal with financial flows and capital movements as the ESCB is responsible for controlling the money supply, promote the smooth operation of the payment systems and to manage the official foreign reserves of the member states.

Art 105.5 provides for a mandate to contribute to prudential supervision of credit institutions and the stability of the financial system. According to Art. 105.6 the Council may even, with the assent of the European Parliament, give the ECB specific tasks on prudential supervision of banks.

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**BOX III: ARTICLE 105 OF THE TREATY OF NICE**

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Art. 105

1. The primary objective of the ESCB [European System of Central Banks] shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4.

2. The basic tasks to be carried out through the ESCB shall be:

- to define and implement the monetary policy of the Community,
- to conduct foreign-exchange operations consistent with the provisions of Article 111,
- to hold and manage the official foreign reserves of the Member States,
- to promote the smooth operation of payment systems.

3. The third point of paragraph 2 shall be without prejudice to the holding and management by the governments of Member States of foreign-exchange working balances.

4. The ECB shall be consulted:

- on any proposed Community act in its fields of competence,

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<sup>65</sup> The other two being the Executive Board and the Governing Council which are composed by representatives of the Eurozone countries.

<sup>66</sup> [http://europa.eu/institutions/financial/ecb/index\\_en.htm](http://europa.eu/institutions/financial/ecb/index_en.htm)

- by national authorities regarding any draft legislative provision in its fields of competence, but within the limits and under the conditions set out by the Council in accordance with the procedure laid down in Article 107(6).

The ECB may submit opinions to the appropriate Community institutions or bodies or to national authorities on matters in its fields of competence [...]

5. The ESCB shall contribute 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.

6. The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

The ECB describes as follows how it implements its mandate on financial stability and supervision:<sup>67</sup>

### **(1) Monitoring of financial stability**

The cyclical and structural developments in the Euro-area/EU banking sector and in other financial sectors are systematically monitored. The purpose is to assess the possible vulnerabilities in the financial sector, and its resilience to potential shocks.

The assessment is done in collaboration with the EU national central banks and supervisory agencies. They are all represented in the ESCB Banking Supervision Committee.

The outcome of this activity is published annually, for example, in the reports entitled “EU banking sector stability”, “Structural analysis of the EU banking sector” and also in the ECB’s Annual Report.

### **(2) Provision of advice**

The ECB is frequently asked by the competent authorities at EU level and national level to contribute its technical expertise to the design and definition of financial rules and supervisory requirements to financial services providers. The ECB can also make a contribution on its own initiative. The ECB wants to ensure that a financial stability perspective is taken into account.

The ECB provides advice through formal consultation on draft Community and national legislation in the area of financial stability and supervision, or through its participation in the relevant international and European forums (for in the Basel Committee on Banking Supervision, and within the Lamfalussy process in the European Banking Committee, European Securities Committee, Committee of European Banking Supervisors).

### **(3) Promotion of cooperation between central banks and supervisors in the EU**

Such promotion includes frequent exchanges of information as it is seen as a pre-condition for maintaining financial stability both on an on-going basis and in times of crisis. Predominantly, this is done by the **Banking Supervision Committee** (BSC). It leads, for example, to memorandums of understanding (MoU) signed by the authorities concerned and which are periodically reviewed in light of market and institutional developments.

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<sup>67</sup> <http://www.ecb.int/ecb/orga/tasks/html/financial-stability.en.html>



The ECB also sits in informal discussion forums. One example is its membership of the “Group of Thirty”<sup>68</sup> (former Bellagio group). The Group of Thirty is an international informal body that includes the heads of major private banks and central banks, as well as members from academia and international financial institutions. The group aims to improve the understanding of financial and economic issues and decisions taken by public and private actors related to among others:

- foreign exchange, currency, etc.,
- international capital markets,
- international financial institutions,
- central banks and supervision of financial services and markets,
- macroeconomic issues such as product and labour markets, etc.

The Group is based in Washington, D.C., “holds two full meetings each year and also organises seminars, symposia, and study groups.”<sup>69</sup>

During the financial and credit crisis in 2007-2008, when banks refused to lend to each other and confidence in the banks was severely undermined, the competence of the ECB and ESCB became very important to provide liquidity in the markets. The ECB was the first to provide liquidity to the financial markets and operators. In August 2007, the ECB acted without coordination with other non EU countries and institutions but when the turmoil hit in Autumn 2008, the ECB was also coordinating at international level (e.g. after the IMF meeting of 12 October 2008). The ECB, in its responsibility of money supply, continued to provide liquidity during the different phases of the financial and credit crisis. The national central banks who hold the money reserves, have the obligation to provide the money liquidity the ECB needs.

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<sup>68</sup> [http://en.wikipedia.org/wiki/Group\\_of\\_Thirty](http://en.wikipedia.org/wiki/Group_of_Thirty)

<sup>69</sup> [http://en.wikipedia.org/wiki/Group\\_of\\_Thirty](http://en.wikipedia.org/wiki/Group_of_Thirty)

## CHAPTER 2: INTERACTION BETWEEN THE INSTITUTIONS

*“Top EU institutions, the Commission, the Council and the Parliament, have complex relationships among themselves, unparalleled in traditional nation constitutional settings. As a consequence, their relationship with economic (and financial) governance is also complex.”*

*“The Commission is often more market oriented, due also to its mission of Treaty’s (single market’s) advocate; the Council reflects more the short-term oriented political opportunisms of national governments while the Parliament feels responsible of democratic control, often with some populism, which puts it in a dialectic position both with national governments and with market forces.”*

Prof. F. Bruni, Università Bocconi and EEGM (Ispi)<sup>70</sup>

This chapter provides an insight into the interactions between the complex structure of different bodies and different levels of decision-making at EU level but also attempts to identify where the centre of decision-making power at the political level lays. The next chapter will indicate the important influence from the financial industrial lobby. The inter-linkages and centres of power cannot only be deduced from the existing decision-making processes, structures and powers, but also from the now obvious fact that there was a failure to regulate or supervise at the EU level and national level as a result that warnings were ignored or could not be voiced within the decision-making structures.<sup>71</sup>

### 2.1. THE FORM OF EU LEGISLATION INFLUENCES THE INFLUENCE BY THE MEMBER STATES

The form of legislation that the Commission (EC) uses to introduce new regulations in the Single Market of financial services also influences the relationship between the EC and the member states. The main form of EU legislation on financial issues is directives and not regulations. Although adopted in the same way - by the Council in co-decision with the European Parliament, or by the Commission alone - directives allow member states to have more say in the way they implement the EU legislative measures than regulations. Indeed, directives are binding on the Member States only as regards the result to be achieved, namely Community objectives through alignment of national legislation. Member states can however choose the form and method to implement directives in line with their national legal structure. However, more detailed implementation measures, which are decided by the EC after directives are agreed, can be carried out by regulations. Regulations are laws that have immediate and direct effect in all the Member States in the same way as national laws, without any further action by the national authorities.

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<sup>70</sup> F. Bruni, “The governance of EU’s financial regulation: challenges from the current financial turmoil, power point presentation London (Chatham House), 25 January 2008.

<sup>71</sup> Some of this information is based on an interview with MEP Ieke van den Burg and other experts, as well as several academic articles (see list of literature).

## 2.2. INTERACTION BETWEEN THE COUNCIL, THE MEMBER STATES AND THE EC<sup>72</sup>

Analysts consider that the political grip on regulation and supervision has increased over the years. This does not mean that regulation was strengthened and sufficient. On the contrary, there was no political will to put in place a system of regulation and supervision that was sufficient to guarantee financial stability while academics, and even supervisors and the financial industry, regarded regulations and supervision insufficient. The lack of political will can be explained by member states' interest in defending the competitiveness of their national financial services industry against those from other EU countries. The Commission joined this competitive game of the financial industry as part of the Lisbon strategy and was also interested in defending the competitiveness of the European financial industry against that of its rivals in the US and in Asia. Regulation and supervision were often seen as a burden and cost. For instance, capital reserve requirements were insufficient – as has been shown by the credit crisis - because there was pressure to maintain competitiveness of one's financial industry and to keep capital as cheap as possible (for SMEs). The neo-liberal thinking of the member states, the central banks, the supervisors and the Commission was all very much influenced by the financial industry who argued how free financial markets allowed a buoyant (ever more speculative) financial industry that was claimed to make important innovations and contributed to job creation, increasing profits, and economic growth.

Member states can impose their influence and (lack of) political will through the following decision making structures. While the European commission's directorate General for the Internal Market has the right to initiate legislation on regulation and supervision of financial services markets and financial markets, it is dependent on the adoption of its proposals by the Council and the European Parliament. The Council of the Ministers of Finance (ECOFIN) and the Member States are important drivers of the decision-making process, much more than the European Parliament (ECON). The ECOFIN decides on a roadmap of directives and measures, within a proposed time frame, which are to be prepared and proposed by the EC and consequently be adopted by the Council and the European Parliament.

Given the complexity of the matters while preparing the planning and adoption of directives, the Ministers often rubber stamp what has been prepared and proposed to them unanimously by the Economic and Finance Committee (EFC), in which each country has a representative from its Finance Ministry and Central Bank, and by the Financial Services Committee (FSC). Strategic work on financial services integration is being prepared by the Financial Services Committee that reports to the EFC and has a representative of each of the member states. Once a proposal for a directive is made to the Council by the EC, the Economic and Finance Committee and the Financial Services Committee are involved in the preparatory work for Ministers to take the formal co-decision. When the Council does not want to approve, amendments or new proposals must be submitted.

The influence of the member states before the EC submits a proposals for a directive or regulation is also felt through its consultation of level 2 Lamfalussy Committees of regulators of banking, insurance and securities. Representatives of member states sit in these Committees and their advice gives the Commission a feeling of member states' positions and policy preferences, and is a

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<sup>72</sup> See for more details of the Lamfalussy committees and their functioning: L. Quaglia, "Financial Sector Committee Governance in the European Union", in *European Integration*, Vol. 30, Nr. 4, September 2008, p. 563-578.

way to influence the Commission.<sup>73</sup> After the adoption of a directive, the competent level 2 Lamfalussy Committees have to vote on their advice on the implementation measures which the EC is adopting.

Even national supervisors (Level 3 Lamfalussy Committees) can play a role in the proposal prepared by the EC since they can be consulted by the EC or they can give a non-requested advice. After the adoption of directive, and before the implementation measures are adopted by the EC and the Level 2 Committees, the relevant Level 3 committees give advice on practicalities (guidelines, interpretations, etc.) to implement and make the transposition of the directive, which they ultimately have to decide themselves.

Nevertheless, the EC has the ultimate decision-making power to initiate and propose regulatory and supervisory measures at the EU level. The DG Markt takes the lead and makes the proposals public after the whole college of Commissioners has agreed to it (i.e. normal procedure). The mandate from the Treaty is to create a free market in financial services and free capital movements, the Lisbon Agenda of increasing competitiveness influences the free market orientation of the EC's proposals.

The political orientation of the Commissioner Charlie McCreevy as well as EC President Barroso has also been an important factor. Commissioner McCreevy has been very reluctant to intervene in the markets and has had clear pro-free market positions. Even in September 2008, he refused to respond positively to recommendations from the EP to regulate hedge funds and private equity although the ECB president had voiced his concern about the lack of supervision on hedge funds. McCreevy has clearly been in favour of self-regulation which now has proven not to work.<sup>74</sup> The free market orientation, the lack of focus on the financial markets and financial industry, and the lack of political will of the EC to initiate regulatory or supervisory measures against the member states' will has often explained why the Commission was not taking the lead during the financial crisis that erupted in September 2008. After some time, the Commission wanted to show it was doing something on the crisis and made proposals for changing regulation and supervision, mostly based on those promoted by the Council (see chapter 4).

Where the relationship between the EC and the member states becomes more difficult is at Level 3 and Level 4 of the Lamfalussy process. Between the EU guidelines, interpretation and standards that provide details on how the directives need to be applied by the regulators and supervisors of the member states and the actual transposition in practice at national level, there is often a gap whereby the level of regulation of supervision is not the same in all countries. For instance, the UK uses its language advantage so that its application is de jure correct but in practice often results in lighter regulation than other member states. There is a small group of EU member countries that is repeatedly slow in transposition and enforcement.<sup>75</sup> Apart from the competitiveness issue and the use of directives, as explained above, there are several other reasons why member states are reluctant to apply EU directives and their implementation measures. Some of the problems relate to the fact that supervisors' primary responsibility is national and no obligation, mandate or means to harmonize at European level. Countries have very different financial regulatory and supervisory

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<sup>73</sup> L. Quaglia, "Financial Sector Committee Governance in the European Union", in *European Integration*, Vol. 30, Nr. 4, September 2008, p. 566.

<sup>74</sup> According to one analyst self regulation does not work e.g. (1) in payment settlement area: the introduced code of conduct does not work because nobody in the industry is setting the first step; (2) a project to map risks by each of the actors: works more or less because there is mutual distrust among the financial industry actors in the current financial crisis situation, but once the situation is better and competition among the financial players starts again, the financial industry actors are likely to be much less willing to give each other information.

<sup>75</sup> F. Bruni, "The governance of EU's financial regulation: challenges from the current financial turmoil, power point presentation London (Chatham House), 25 January 2008.

cultures, institutions and capacities. Supervising authorities have different roles in many member states, whereby in some countries integrated financial supervisory authorities were put in charge while the role of the central banks became limited to monetary policy and the maintenance of price stability. Given that supervision is still a national competence, it means that the costs of bailing out a failing bank with cross-European operations and paying deposit guarantees to its saving clients/depositors, remains with the national supervisors and their national taxpayers. This is used as an argument to keep supervision national as long as there is no EU level deposit guarantee system and burden sharing.

The lack of EU wide supervisor was described by one analyst as the result of turf wars by member states and bureaucracies of supervisors and central banks, which want to keep their job. In addition, according to one view, the Commission is not interested in increasing the power and status of supervisors cooperating at level 3 because Commission officials would like to become more or less as independent as DG competition.

Consequently, the EU ministers of finance have for instance repeatedly declared during the beginning of the European credit crisis that the supervisory framework cannot be altered notwithstanding that the operation of an EU-wide financial markets and financial industry and the lack of supervision at the EU level is being considered as a major cause of the financial crisis.<sup>76</sup>

However, in future the cooperation at Level 3 might be a basis to work out a supervisory body at EU level. Many experts are calling for more powers for the Level 3 Committees. In addition, a High Level Group on cross-border financial supervision (de Larosière Group) has been created in the second half of October 2008 to propose solutions to this perceived problem.

At level 4, the Commission in principle needs to sue with legal procedures up to the European Court of Justice if a member states fails to correctly apply the directive or regulation. However, in practice it is difficult for the EC to start such long and complex procedures for minor breaches.

### 2.3. THE RELATION BETWEEN THE EUROPEAN PARLIAMENT (EP) AND THE EC AND THE COUNCIL

Since the EP has no power to initiate legislation, the EP proposes to the Commission to initiate some regulatory decisions through own initiative reports and resolutions. However, the Commission can deny these reports or resolutions, and has been doing so. Only when passed with a large majority will an own initiative report or resolution give a strong signal to the Commission while in practice only a qualified majority (based on numerical counting) is needed. This means that a lot of compromises and behind the scenes work is done among the political parties at the EP.

The relations between the Council (ECOFIN) and the European Parliament (ECON Committee) are not very close, although both have together co-decision power on the same issues related to regulating financial services. The EP tries to informally influence ECOFIN, e.g. by being around at the informal ECOFIN meetings and related conferences. The EP also meets with the EU presidency, and invites the chairs of the Economic and Financial Committee and the Financial Services Committee of the Council.

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<sup>76</sup> K. Lannoo, "The crisis, one year on", CEPS commentary, 7 August 2008

The European Parliament is discussing how it can have a better insight and control over implementation after it co-adopted directives, since it considers that there is currently a lack of democratic control over implementation. The Commission is supposed to take careful account of the European Parliament's position when taking measures of implementation. It has been agreed that the EP can intervene when the EC exceeds its mandate regarding the implementation measures adopted by the EC. It interacts with level 2 Committees by asking them to give testimonies. However, the EP cannot interfere in the process of transposition and control of implementation (Level 3 and 4 of the Lamfalussy process) of the directives it co-adopted. The EP, however, asks the chairs of the Level 3 Committees to speak at the EP and discuss the work plans and reports of the different level 3 committees.

## 2.4. THE ECB: PRESENT IN MANY COMMITTEES

While the ECB has no formal role in supervision of financial markets, its advisory role is wide-ranging, thus having an informal influence reaching far beyond its official mandate. In practice, the ECB is sitting in many EU institutions such as the ECOFIN and the ECOFIN's Economic and Financial Committee and the Financial Services Committee, different Lamfalussy process committees, and the European Conglomerates Committee. The ECB has regular contacts with relevant Directorates General of the Commission (such as DG MARKET, DG Economic and Financial Affairs, and Eurostat) and gives frequent testimonies at the European Parliament. Also the ECB participates in many international institutions (see below chapter 5). In this way, the ECB is able to communicate its opinions and insert them in decision-making structures at different EU institutions. The ECB's publications and statistics also play an important role in the EU financial discussions.

## 2.5. CONCLUSION

The member states, through the different bodies in which they are represented, have an important role in the decision-making process and on what EU wide regulatory and supervisory measures are being proposed and agreed. At the Council level, the Economic and Financial Committee (EFC) and the Financial Services Committee – which reports to the EFC – are important bodies of decision-making. At the Commission level, the Level 2 Committees in which member states are represented, seem to have an important influence before decisions are made.

However, the Commission itself – and its wide ranging consultation procedures (see below chapter 3) – has in the past proved to be a key player. Even after the head of states have taken more initiatives to propose legislation in the wake of the financial crisis since September 2008, constitutionally the EC is still important as it initiates the appropriate procedures and regulations to implement what the EU leaders have proposed.

The European Parliament has had little influence so far in influencing the agenda implementation of the regulatory and supervisory measures but its influence is seen as growing.

## CHAPTER 3: THE FINANCIAL LOBBY AND INFLUENCE OF OTHER STAKEHOLDERS<sup>77</sup>

Lobbying is a phenomenon that is present in all political systems and it is not too surprising to raise the issue of lobbying in the context of the formal governance structures of financial markets and the financial industry. However, the complex and opaque EU structures dealing with financial issues inevitably result in a specific quality of lobbying, which gives much more influence to vested interests who have the resources to organise a systematic lobby work.

This chapter describes how the lobbying by stakeholders of the EU institutions involved in decisions about the financial services and markets, happens through official channels, such as public consultations, as well as through informal means, such as closed meetings between lobbyists and decision-makers or officials.

### 3.1. IMBALANCED INFLUENCE BY STAKEHOLDERS

It is recognized that lobbying by the financial industry is the most influential since it has huge amounts of resources to undertake its own lobbying activities and participate in official consultation procedures. The consumer organisations, trade unions, and specifically their European representatives, are much less influential, often due to their lack of human resources and expertise. They are far outnumbered by the financial industry in official consultation settings organised by the DG Markt and the Lamfalussy Committees. In areas where stakeholders not part of the financial service industry have expertise and know their dossiers, their critical contribution can play a role. On issues of availability of cheap credit, for instance, which is related with the regulations on capital reserves to held by banks that provide credit, small and medium sized industry representatives are also very active in lobbying, with some success.

The imbalance of influence by lobbyists is some matter of concern at official level. Therefore, the EC, established the Financial Services Consumer Group (FSCG) as a sub-group of already existing European Consumer Consultative Group (ECCG). The FSCG is a permanent committee that brings together representatives of consumer organisations from each of the Member States and those active at EU level, to discuss financial services policies and proposals of particular relevance to consumers. The overall objective of the ECCG working group on financial services is to ensure that consumer interests are properly taken into account in EU financial services policy development.<sup>78</sup> The EC also established a Forum of Financial Services Users (“FIN-USE”) within the context of better European governance. The Commission committed itself to opening up its policy-making and being more inclusive within the context of the social aspects of the review of the European Single Market and its objective to ensure that nobody is denied access to a basic bank account. This forum of financial services users is to secure expert input, e.g. during the early stage of legislative initiatives,

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<sup>77</sup> Some of this information is based on an interview with MEP Ieke van den Burg as well as several academic articles (see list of literature).

<sup>78</sup> [http://ec.europa.eu/internal\\_market/finservices-retail/fscg/index\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/fscg/index_en.htm): The group has to contribute to: Raising awareness and informing EU and national consumer representatives on ongoing and envisaged Commission initiatives in the financial services area; Drawing the Commission's attention to specific problems of concern to consumers in the area of financial services; Ensuring adequate representation of consumer interests in the development of financial services policy; Encouraging the development of financial services expertise among EU and Member States consumer organisations.

on the user side into internal market financial services initiatives so that a more active and informed involvement of users can be achieved.<sup>79</sup>

The European Parliament is considering providing a budget to consumer organisation representatives in order to increase their human and financial resources to contribute to the consultation processes organised by the EC.

### 3.2. LOBBY ACTIVITIES BY THE FINANCIAL INDUSTRY

*“It is a common phenomenon in all areas of regulation that regulators become ‘captured’ by the industry they regulate, meaning that they take on the objectives of management in the firms they regulate. They may thereby lose sight of the ultimate objectives of regulation. Regulatory capture is particularly serious in industries such as banking where there is a conflict of interest between the firms’ objectives (to maximise profits) and the objectives of the regulation (to provide consumer protection and maintain systemic stability).”<sup>80</sup>*

Given the generally weak and fragmented structures of European regulation and supervision, the very strong lobbying of the financial industry plays a particularly important role at the different levels of decision-making. The extent to which the financial industry lobbies and influences the decision-makers, often depends on the issues and how future regulations will affect them. The more concrete the EU decisions are which will affect the operations and costs of the financial industry, the more active they are.

The financial industry lobbies, among other means, through official channels of consultation organised by EU institutions. One of the reasons why the financial industry is officially consulted is because of the complexity of the issues and the lack of expertise and knowledge amongst national or EU officials. The EC, for instance, lacks the expertise to deal with the complex financial products and so consults the industry. Sometimes such consultations may change the EC's proposals. However, the EC might be too interested in the view of the financial industry. For instance, after having received advice from the Lamfalussy Committees, the EC often seeks advice from business through official consultation processes with business. This might give the latter an important voice to secure the financial industry interests as they were also consulted before advice was asked from the Lamfalussy Committees. The Lamfalussy Committees also need the cooperation from the financial industry in order to obtain information about the situation in the market place.

At the national level, some lobbying is taking place on specific issues so as to influence the positions of the member states sitting in different committees at the Council and Commission level. The lobbyists also put pressure not to regulate or supervise too much at national and EU level in order to remain competitive compared to the FSI of other (EU) countries. In general, the financial industry lobby is based on the arguments that they have been introducing important innovations and have been creating jobs, income and economic growth. Some financial industry members threaten to leave the country if that country were to introduce new regulations that they consider too costly.

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<sup>79</sup> [http://ec.europa.eu/internal\\_market/finservices-retail/finuse\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/finuse_en.htm): a conference was organized to that objective pm 28 May 2008 by DG Internal Market and Services and DG Employment, Social Affairs and Equal Opportunities

<sup>80</sup> H. Benink, R. Schmidt, “Europe’s single market for financial services: views by the European Shadow Financial Regulatory Committee”, Journal of Financial Stability, 2004, p. 186.



### 3.2.1. FORMAL LOBBYING AT DIFFERENT LEVELS

At the EU level, DG Markt consults widely with the financial industry before a directive is proposed and during the follow-up procedures of implementation and transposition of directives (ANNEX V: Consultations on line by DG Internal Market). The financial lobby groups are engaged in the many official consultation processes organised by DG Markt, its Committees and working groups, according to banking, insurance and securities' topics. These consultations include (1) discussions at expert groups or working groups officially created by DG Markt, (2) consultations through internet where calls are made to submit written (virtual) comments on proposals from the Commission by a certain deadline, and (3) conferences organised by the EC on specific topics and to which the financial industry is invited. The consultation process can have several 'rounds': internet consultations to provide comments to the EC are sometimes requested by the EC after the EC already changed a proposal resulting from a first round of internet consultations. For a full overview of the consultation documents between 2005 and 2008, see ANNEX V.

Each of the Lamfalussy Committees also has their consultations with the financial industry and other stakeholders or experts. For instance, the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS) have a consultative panel that meets 4 times a year.

DG Trade is also heavily lobbied by the financial services lobby which, not always the same as the ones lobbying on regulations. Although there seems to be little formal channels of consultation, DG Trade organises some regular half day 'dialogues' on particular trade negotiations with 'civil society' meaning all stakeholders including business. However, this is not the only way the financial lobby expresses its opinions and more informal channels exist which are not used by other stakeholders. The DG Trade position in the negotiations of the World Trade Organisation (WTO) on financial services, as part of the General Agreement on Trade in Services (GATS), are clearly reflecting the interests of the financial services industry. The financial lobby is also behind the proposal during the current GATS negotiations on domestic regulation to include a rule whereby foreign service suppliers should be allowed to give comments before legislation is adopted in parliament of the host country - a proposal that the EC has supported during the GATS negotiations.<sup>81</sup>

At the European Parliament, the Economic and Monetary Affairs Committee (ECON) officially organizes cross party/cross-political discussions with the financial industry. Such meetings are organised in the context of the European Parliamentary Financial Services Forum (EPFSF)<sup>82</sup> whose official membership only includes European financial industry umbrella organizations, some specific national branch organizations, and representatives of very large financial industry players. The EPFSF forum is managed by both MEPs and the financial industry representatives (who have to pay up to maximum 20,000 Euro to be members of the forum). The EPFSF organises, among others, meetings at the EP, which deal with particular issues and are in principle only attended by MEPs and the financial industry members of the EPFSF forum. The EPFSF also produces briefing papers on particular issues and regulatory proposals. The MEPs of ECON are interested in having the big financial industry players at the forum events and to have an insight on how the different actors in the financial industry react to each other during their discussions at the EP.

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<sup>81</sup> See several publications by M. Vander Stichele, e.g. M. Vander Stichele, K. Bizzarri, L. Plank, Corporate Power over EU Trade Policy: Good for business, bad for the World, produced by the Seattle to Brussels Network, October 2006, <[http://www.s2bnetwork.org/download/Corporate\\_power\\_over\\_EU\\_Trade\\_policy\\_Sept\\_2006.pdf](http://www.s2bnetwork.org/download/Corporate_power_over_EU_Trade_policy_Sept_2006.pdf)>

<sup>82</sup> See <[www.epfsf.org](http://www.epfsf.org)> : the director, Catherine Denis, and the Financial Industry Committee, chaired by Guido Ravoer (European Banking Association) are managing the forum, based at Rue Montoyer 10, B-1000 Brussels.

ECON also has a Panel of Experts such as the Monetary Experts Panel which deals with inflation, monetary policy, lender of last resort.<sup>83</sup> These experts also include academics.

### 3.2.2. INFORMAL FORMS OF CONSULTATION AND LOBBY

The financial industry has huge financial resources and different ways to informally lobby the different levels of the EU decision-making process. The most common forms are writing letters and informal meetings. For instance, the lobby of the financial industry (especially the insurance companies) which individually approaches MEPs in written or other ways, is strong. At DG Trade, the financial lobby seems to be organised mostly informally and through privileged contacts e.g. by meeting the Commissioner or regular contacts with DG Trade officials on negotiation documents (which are secret for the public), or through questionnaires commissioned by the Commission.<sup>84</sup>

Forms of informal lobbying include, for instance, the Members of the European Financial Services Round Table are the Chief Executive Officers or Chairmen of leading European insurers and banks.<sup>85</sup> Apart from writing letters and position papers addressed directly to the Commissioners and the President of the Commission, and meeting with Commissioner McCreevy, they try to organize meetings or dinners with Ministers, especially from the country holding the presidency. The financial industry also organizes its own meetings, such as the Annual European Financial Services Conference, at which the Commission and other policy makers are invited and where exchange of views and informal talks can take place.

### 3.2.3. HOW THE LOBBY IS ORGANISED AT EU LEVEL

The financial industry organises its lobbying through a range of varied ways, such as:

(1) Branch organisations or associations have a clear mandate to lobby and involve company decision-makers are involved at different levels (e.g. EC level or internal industry working groups, representation during consultation meetings with EC). Many of them have particular contact persons per working group at the level of the EC, Lamfalussy Committees or even the Council (ECOFIN). These branch organisations are organised EU wide, or on a national basis such as the influential and well-connected International Financial Services London (IFSL) and the related LOTIS Committees.<sup>86</sup>

At the European level, there are many lobbying branch organisations: some are more general, while others are related to very specific financial sub-sectors. Among the important general ones are:

- AMICE - Association of Mutual Insurers and Insurance Cooperatives in Europe
- BusinessEurope (the overall umbrella organisation of employers in the EU)
- BIPAR - Bureau International des Producteurs d'Assurances et de Réassurances
- CEA - Comité Européen des Assurances
- EFRP - European Federation for Retirement Provision
- European Association of Cooperative Banks

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<sup>83</sup> <http://www.europarl.europa.eu/activities/committees/editoDisplay.do?menuId=2037&id=1&body=ECON&language=EN>

<sup>84</sup> See several publications by M. Vander Stichele

<sup>85</sup> See for more information: <[www.efr.be](http://www.efr.be)>

<sup>86</sup> See : <http://www.corporatewatch.org.uk/?lid=382#bottom>

- EALIC - European Association of Listed Companies
- EAPB - European Association of Public Banks
- EBF/BFE - European Banking Federation/Banking Federation of the European Union
- EFBS - European Federation of Building Societies
- EFRP - European Federation for Retirement Provision
- EFAMA - European Fund and Asset Management Association
- EMF - European Mortgage Federation
- ESG - European Savings Banks Group
- CRO Forum - The Chief Risk Officer Forum

The European Banking Industry Committee (EBIC) coordinates the position of some of the main financial branch organisations from the credit sector industry “throughout the process of drafting, adopting, implementing and enforcing EU-financial legislation” by the EC, the Lamfalussy Committees and other European institutions. The members of EBIC are: Banking Federation of the European Union, European Savings Banks Group, European Association of Cooperative Banks, European Mortgage Federation, European Federation of Building Societies, EUROFINAS/LEASEUROPE, and the European Association of Public Banks.

Per specific issue, a whole range of very specialised lobby organisations are also taking part in the consultations and lobbying. For instance, groups that have played a role in EU legislation on the savings tax directive are: the Alternative Investment Management Association, the Association of Mutual Insurers and Insurance Cooperatives in Europe, the European Central Securities Depositories Association, the European Forum of Securities Associations, the Federation of European, the International Capital Market Association, the International Swaps and Derivatives Association, the Society of Trust and Estate Practitioners.<sup>87</sup>

(2) Large financial companies lobby individually through their own lobbyists. By being spokespersons for their branch organisations during consultations, they also can emphasize the interests of their own financial company.

(3) Lawyers and consultants are hired by branch organizations or individual companies to lobby by providing detailed input that defends their perspective and interests.

(4) Revolving doors: members of the European Parliament (MEPs) are being headhunted to become lobbyists for the industry, or lobbyists are elected to become MEPs. Some MEPs have direct or commercial links with the (financial) industry.<sup>88</sup>

### 3.2.4. LOBBYING BY THE EU FINANCIAL INDUSTRY AT INTERNATIONAL LEVEL

The European financial industry is also active at the international level and lobbies together with the financial industry of other major countries, including the US. For instance, the Financial Leaders

<sup>87</sup> See composition at:

<[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/personal\\_tax/savings\\_tax/consultation/EGTS-list.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/personal_tax/savings_tax/consultation/EGTS-list.pdf)>

<sup>88</sup> See for instance: <<http://www.worstlobby.eu/2008/>>

Group<sup>89</sup> has been very active during GATS negotiations on financial services during and after the previous WTO round of negotiations. The Institute of International Finance (IIF) is the most powerful lobby organisation of the internationally operating financial industry, and lobbies at international level such as towards the meetings of the International Finance Committee at the bi-annual meetings of the IMF, and towards other bodies such as the Financial Stability Forum. In autumn 2008<sup>90</sup>, Josef Ackermann, CEO of Deutsche Bank, was chair and different CEOs of European banks are members of the board of IIF.

### 3.3. ACADEMICS AND THE EC DECISION-MAKING BODIES

Academics are often asked to provide their input by different regular or ad hoc consultation forums at the EC, the Lamfalussy Committees and the European Parliament. Some of them are organised in platforms such as the Centre for European Studies (CEPS) which issues regular publications, briefings and commentaries on financial sector issues<sup>91</sup> and the Breughel institute.<sup>92</sup> Some platforms of academics are more neutral or independent in relation to their ideology or contacts with business than others.

However, academics have traditionally not had strong relations with financial regulators and supervisors, and many of their warnings and criticism of the EU financial architecture have not been heard.

Because national regulators and supervisors have since long shielded their activities from scrutiny, while crises occur regularly, academics have formed ‘shadow financial regulatory committees’ in the US – where it started – , Europe, Japan and Latin America. These committees meet together once a year.<sup>93</sup>

The European Shadow Financial Regulatory Committee (ESFRC) focuses especially on the lack of mechanisms at the EU level (e.g. related to supervision, deposit guarantees/insurance, securities trading, take-overs, capital requirements) and on gaps to deal with the European wide and globalised financial industry and financial markets.<sup>94</sup> The Committee meets three times a year to discuss and critically analyse issues of EU financial regulation and supervision, and to publish policy recommendations in the form of statements.<sup>95</sup> The ESFRC has often published critical comments and constructive advice, based on principles of free markets and EU wide integration, to highlight the need for regulations and supervision at EU level, and increase the level of regulations to deal with different kind of risks from the operations of the financial industry. For instance, they argued in March 2008 that “[c]urrently, national authorities from the 27 Member States of the EU meet in a

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<sup>89</sup> M. Vander Stichele, Critical issues in the financial industry, SOMO, 2005, p. 161. [www.uscsi.org/groups/finleader.htm](http://www.uscsi.org/groups/finleader.htm)

<sup>90</sup> Downloaded at < <http://www.iif.com/about/bod/>>

<sup>91</sup> See: <http://www.ceps.be>

<sup>92</sup> <http://www.bruegel.org>

<sup>93</sup> H. Benink, R. Schmidt, “Europe’s single market for financial services:views by the European Shadow Financial Regulatory Committee”, *Journal of Financial Stability*, 2004, p. 163.

<sup>94</sup> For more explanation see for instance: H. Benink, R. Schmidt, “Europe’s single market for financial services:views by the European Shadow Financial Regulatory Committee”, *Journal of Financial Stability*, 2004, p. 157–198; European Shadow Financial Regulatory Committee, Press release, March 2006, <[http://www.ceps.eu/Article.php?article\\_id=285](http://www.ceps.eu/Article.php?article_id=285)>

<sup>95</sup> For an overview see: [http://www.ceps.be/Article.php?article\\_id=266](http://www.ceps.be/Article.php?article_id=266); on different websites, the topics ESFRC deals with are described as ” remaining barriers to the completion of the EU single market for financial services, guidelines for the design of financial services regulation, the pros and cons of universal banking and bancassurance, banks and derivatives, electronic payment services by non-banks, supervision of financial conglomerates and non-banks, supervision on a European level vs. home country control, capital requirements, and state ownership and/or support of financial institutions.”

multiplicity of regulatory and supervisory committees, often with overlapping responsibilities. Despite the plethora of committees, specific institutional arrangements to deal with crisis management at the European level appear to be insufficient and, in any event, are not transparent.”<sup>96</sup>

Members of the ESFRC are European professors and other independent experts in the fields of banking, finance and the regulation of financial institutions and markets.

According to the latest press release in March 2008<sup>97</sup>, there are 13 members of the Committee. The latest list of ESFRC members available on the internet is from 2006 and consists of the following 14 members, coming from 12 European countries:

- Belgium: Karel Lannoo (Centre for European Policy Studies, Brussels)
- Denmark: Niels Thygesen (University of Copenhagen)
- Finland: Tom Berglund (Swedish School of Economics and Business Administration, Helsinki)
- France: Christian de Boissieu (University of Paris I – Sorbonne)
- Germany: Friedrich Kübler (Johann Wolfgang Goethe University & Clifford Chance, Frankfurt & University of Pennsylvania, Philadelphia, United States)
- Reinhard H. Schmidt (Johann Wolfgang Goethe University, Frankfurt)
- Hungary: Jacek Rostowski (Central European University, Budapest)
- Italy: Franco Bruni (Bocconi University, Milan)
- Netherlands: Harald Benink (Erasmus University, Rotterdam & FMG/LSE)
- Spain: Rosa Lastra (University of London & FMG/LSE)
- Sweden: Clas Wihlborg (Copenhagen Business School)
- United Kingdom: Philip Davis (Brunel University, London & FMG/LSE)
- Switzerland: Hans Geiger (University of Zurich)
- Gérard Hertig (Swiss Federal University of Technology, Zurich)

Prof. Harald Benink from the Netherlands was still chair and Karel Lannoo still the Belgian member in November 2008.

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<sup>96</sup> European Shadow Financial Regulatory Committee (ESFRC), “Resolving the Current Crisis and Preventing its Return”, Statement Nr. 2718, Brussels, March 10, 2008, <[http://www.ceps.eu/Article.php?article\\_id=583](http://www.ceps.eu/Article.php?article_id=583)>

<sup>97</sup> [http://www.ceps.be/Article.php?article\\_id=266](http://www.ceps.be/Article.php?article_id=266); European Shadow Financial Regulatory Committee (ESFRC) - Statement No.2718 - Resolving the Current Crisis and Preventing its Return”, Brussels, March 10, 2008, <[http://www.ceps.eu/Article.php?article\\_id=583](http://www.ceps.eu/Article.php?article_id=583)>

# CHAPTER 4: REGULATORY AND SUPERVISORY ACHIEVEMENTS OF EU DECISION-MAKING STRUCTURES

The complex decision-making structures and processes make it difficult to provide a good oversight of what have been the main regulatory and supervisory achievements. However, the financial crisis has exposed the many weaknesses of the European financial architecture. Since the credit crisis disrupted the financial markets and stopped inter-bank lending from September 2008 onwards, old and new initiatives to regulate and supervise the financial industry and financial markets have been taken forward

## 4.1. REGULATORY AND SUPERVISORY ACHIEVEMENTS

This complicated decision-making process has achieved, among other things, directives on some important matters in financial markets and the financial industry. Not all of the decisions and directives taken and adopted have gone through the Lamfalussy process (for a list of the achievements of the Lamfalussy process by Autumn 2007<sup>98</sup>, see ANNEX 1).

Important directives and implementation or supervisory measures that attempted to harmonise financial legislation at EU have for instance been:

- the Capital Requirements Directive (CRD) which imposed the same level of capital adequacy on banks, other credit institutions and investment firms;
- 'Solvency I' directive which imposed the minimum capital reserves to be held by insurance companies;
- the Markets in Financial Instruments Directive (MiFID) which harmonised the regulatory regime for investment services with the objective to liberalise investment services across the 30 member states of the European Economic Area (the 27 Member States of the European Union plus Iceland, Norway and Liechtenstein) and to protect the consumer of investment services
- many directives and implementation legislation for securities trading especially to deal with transparency (e.g. Directive on Harmonization of Transparency Requirements) and avoid abuses and manipulation, including insider information (e.g. the Market Abuse Directive).

## 4.2. ISSUES ON WHICH THE EU IS CURRENTLY WORKING

Before the financial crisis erupted in the EU in September 2008, the EU was working on many financial issues at different institutions and different levels, such as:

- the review of the Lamfalussy process, including strengthening supervisory convergence;
- refinements to the Trading Book Capital Requirements Directive for 'incremental' risks and for securitisations and other risk transfer products<sup>99</sup>;
- the review<sup>100</sup> of the Financial Conglomerates Directive (Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate).<sup>101</sup>

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<sup>98</sup> Review of the Lamfalussy process Strengthening supervisory convergence - Communication from the Commission, (COM(2007) 727 final)

<sup>99</sup> [http://ec.europa.eu/internal\\_market/bank/regcapital/index\\_en.htm#directive](http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#directive)

<sup>100</sup> See: [http://ec.europa.eu/internal\\_market/financial-conglomerates/index\\_en.htm](http://ec.europa.eu/internal_market/financial-conglomerates/index_en.htm)

Also being reviewed is a set of directives on 'Undertakings for Collective Investment in Transferable Securities' (UCITS) which was adopted in 2003, to become UCITS IV. The aim was to “allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state. In practice many EU member nations have imposed additional regulatory requirements that have impeded free operation with the effect of protecting local asset managers.”<sup>102</sup>

The crisis on European financial markets and in European banks since September 2008, has accelerated existing initiatives included in the ‘roadmaps’ that were already agreed upon by ECOFIN and some new initiatives, spurred by the calls from the heads of governments for increased regulation and supervision.

The new initiatives, that need to go through the decision-making and implementation procedures as described above (which normally take a year) but some of which are now being adopted more swiftly, cover mainly the following issues (so far):

- (1) Amendments to the Capital Requirements Directive (CRD), setting capital requirements for credit institutions and investment firms.<sup>103</sup> In a response to the financial turmoil, and following earlier discussions and consultations, the Commission has adopted on 1 October 2008 a proposal to amend the CRD in certain key areas to address the shortcomings in the current regulatory framework. Indeed, the CRD had failed in its objective to ensure continuing financial stability, maintaining confidence in financial institutions and protecting consumers. “In addition to the above proposal, the Commission also plans certain technical changes that were approved by the European Banking Committee and have been submitted to the European Parliament for scrutiny.”<sup>104</sup>
- (2) Regulation of rating agencies.<sup>105</sup>
- (3) Amendments to the Regulation related to the application of fair value measurement when markets become inactive (the valuation of speculative financial products in the books) (Regulation EC No 1725/2003 regarding International Accounting Standard (IAS) 39 and International Financial Reporting Standard (IFRS) 7).<sup>106</sup>
- (4) Introduction of an EU wide deposit guarantee (protection) of minimum 100,000 Euro per saving account.<sup>107</sup>
- (5) Introduction of an executive pay directive to avoid incentives such as bonuses that lead to excesses.
- (6) Dealing with transparency and regulation of hedge funds may be formally considered.

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<sup>101</sup> For more information see a.o.: [http://ec.europa.eu/internal\\_market/financial-conglomerates/index\\_en.htm](http://ec.europa.eu/internal_market/financial-conglomerates/index_en.htm)

<sup>102</sup> [http://en.wikipedia.org/wiki/Undertakings\\_for\\_Collective\\_Investments\\_in\\_Transferable\\_Securities](http://en.wikipedia.org/wiki/Undertakings_for_Collective_Investments_in_Transferable_Securities)

<sup>103</sup> [http://ec.europa.eu/internal\\_market/bank/regcapital/index\\_en.htm#directive](http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#directive)

<sup>104</sup> [http://ec.europa.eu/internal\\_market/bank/regcapital/index\\_en.htm#directive](http://ec.europa.eu/internal_market/bank/regcapital/index_en.htm#directive)

<sup>105</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1684&format=HTML&aged=0&language=EN&guiLanguage=en>

<sup>106</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:275:0037:0041:EN:PDF>

<sup>107</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1508&format=HTML&aged=0&language=EN&guiLanguage=en>

In October 2008, a new committee of “Wise men”, de Larosière Group, was set up to advise on ways to improve supervision at the EU level, especially of cross border financial service companies.<sup>108</sup> EU wide supervision has always been a hot issue. On the one hand, national supervisors need to have enough flexibility to deal with national circumstances and deal with the national financial industry. On the other hand, cross-border financial services providers need more supervision at the EU level in order to avoid that they play off countries against each other or force a bail-out by the home countries. Regarding EU-wide supervision of cross-border banks and insurance companies, proposals are being discussed whereby the lead supervisor would have the final say. However, there is opposition by the host supervisors, especially by Central and Eastern European countries who want to have more influence as host supervisors. The UK is taking a self interest stance and does not want to give too much final say to the home supervisor since some of its banks are being bought up by foreign (e.g. Spanish) banks. There is a proposal to have a possibility by the host supervisors to appeal and to ensure that not only national interests of the home supervisor play a role.

### 4.3. ASSESSMENT OF EU FINANCIAL ARCHITECTURE FUNCTIONING AND WEAKNESSES

The current financial turmoil has clearly shown that the many EU structures and legislation have not functioned to avoid a financial crisis and to provide for quick measures to restore financial stability, support distressed banks under a credit crisis, and deal with failing banks.

A major cause is the fact that the EU mandate allows for liberalisation of financial markets and capital, and liberalisation of financial services while no EU wide supervisory instruments are in place. The EU institutions have no mandate in financial supervision and the member states have often been weak in enacting on the coordination and harmonization instruments and directives.

The prudential framework for pan-European banks has become a maze of national authorities (51 are members of CEBS alone), EU-level committees (no fewer than nine) and bilateral arrangements (around 80).<sup>109</sup> Lack of political will at the highest level has been an important obstacle to build EU level regulation and supervision of financial markets and the financial industry.

#### **Failures of the European regulatory structure:**

Warnings about the weaknesses of the regulation to deal with rapid developments in the financial services market, complex individual financial companies and innovative products, were ignored or had no way to channel their concerns through the existing consultation mechanisms which are dominated by vested interests of the financial industry.

There was no common agreement for bank deposit insurance and thus no collective burden-sharing mechanism, which led countries to act independently in early October 2008.

#### **Failures of the supervision structure and crisis prevention:**

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<sup>108</sup> “Barroso - De Larosière : extracts front the joint press briefing by EC President, José Manuel Barroso and Jacques de Larosière, Chairman of the High Level Group on cross-border financial supervision”, press briefing by the European Commission, 22 October 2008, <<http://ec.europa.eu/avservices/services/showShotlist.do?out=PDF&lg=En&filmRef=59668>>

<sup>109</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>



- At the level of the Council of Ministers: “Ministers have repeatedly emphasised in their statements on the financial crisis that the present supervisory framework cannot be altered, meaning that no new grand vision is needed for supervision in the EU”<sup>110</sup>.
- Countries with cross-border banks did not give information to supervisors in host countries: no information about a cross-border bank was provided to a central institution (confidentially) so that a full oversight of actions and problems of a cross-border bank would be possible. “No national or European authority presently has routine access to supervisory information on all pan-European banks, and in-depth knowledge of their developments”<sup>111</sup>.
- Lack of clarity about the roles and responsibilities between home and host supervisors of cross-border financial groups.
- There has been too little enacting and progress in relation to the many warnings about the lack of cooperation about supervision regarding large cross-border financial industry groups.<sup>112</sup>
- DG Competition and national competition laws have no mandate to prevent banks becoming too big or too interconnected to fail.

#### **Failures of the EU principle to liberalise the financial industry:**

- The EU financial architecture is based on the assumption that all EU countries are equal, but small countries like Belgium with large cross-border banks like Fortis are too small to take over i.e. to nationalise the bank in cases of crisis.
- The competition between the cross-European banks undermined cooperation and convergence among EU countries as some official measures might support some kind of banks (dominant in some countries) more than others: the competition among the financial industry has become competition between EU member states.
- Liberalization of financial services and financial markets took place before the right regulation and supervision for crisis prevention, crisis management and crisis solution (at international and EU level) were being set up.
- The European banks were considered to be less profitable than the US ones<sup>113</sup> so there was high pressure to make them more competitive and thus not undermine that competitiveness by too costly or ‘burdensome’ regulation and supervision.

#### **Convergence and harmonization: to what?**

Some EU member state countries have been afraid that the Anglo Saxon model of regulation and supervision would dominate at the EU if harmonization would take place at EU level. These fears have proven now justified as the model whereby prudential supervision was moved away from central banks to become the tasks of integrated financial supervisory authorities (FSAs) as happened in the UK has not worked.<sup>114</sup> Diversification also seems to have its advantages as it helps to provide new models to which others can turn to in times of failures. For instance, the Dutch model is

<sup>110</sup> K. Lannoo, “The crisis, one year on”, CEPS Commentary, 7 August 2008, < [http://shop.ceps.eu/BookDetail.php?item\\_id=1690](http://shop.ceps.eu/BookDetail.php?item_id=1690)>

<sup>111</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>112</sup> Interinstitutional Monitoring Group, Final report monitoring the Lamfalussy process, Brussels, 15 October 2007, p.19-20.

<sup>113</sup> N. Véron, Is Europe ready for a major banking crisis?, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>114</sup> K. Lannoo, “The crisis, one year on”, CEPS Commentary, 7 August 2008, < [http://shop.ceps.eu/BookDetail.php?item\\_id=1690](http://shop.ceps.eu/BookDetail.php?item_id=1690)>: “The critics of the FSA model – who complain of an excessively legalistic and box-ticking approach to supervision and one that loses sight of the broader picture – have been proven right. . Keeping prudential oversight under the same roof as the central bank should allow better detection of macro-prudential risks.”

sometimes referred to as an important model. “The Dutch “twin peaks” model as the long-term ambition for the US. Under that structure the central bank is also in charge of prudential supervision, with business control left to a separate authority”.<sup>115</sup> However, that does not yet solve the full oversight and supervision of cross-border banks or insurance companies that take both home and host country interests into account in an equitable manner.

#### **Failure of structures in crisis management:**

The EU failed to enact warnings that it lacked an effective EU framework and institutional arrangements on crisis management in which supervisors, central banks and finance ministers cooperate closely. Especially the lack of cooperation between supervisors and central banks of countries in which financial industry groups operate with significant cross-border business as well as with innovative products, is seen as a major shortcoming to manage financial crises and is considered a “weak link” in the EU financial framework.<sup>116</sup>

“If problems emerge in a pan-European bank, there are no agreed rules on early intervention and remedial action” i.e. lack of ex-ante cross border arrangements.<sup>117</sup> In the event of a financial crisis, “non-binding supervisory MoUs or voluntary mediation mechanisms may not have much impact when weighed against the potency of national mandates.” Protection of national interests is likely to dominate in times of crisis in this way,<sup>118</sup> i.e. there is no honest broker to represent the common interest. Neither the Economic and Financial Committee, which brings together the EU’s finance ministries, nor the ECB, nor the Commission are likely to prove able to “provide the necessary services of multilateral coordination and political buffering”<sup>119</sup> “The European Commission responsible for the internal market, for competition and for economic and financial affairs still lack the cohesiveness to manage financial crises.”<sup>120</sup>

#### **Failure to set up working mechanisms for financial crisis resolution:**

There has been “lack of agreement between countries on the role (if any) public funding should play in crisis resolution, and on the division of tasks between supervisors in ‘home’ (headquarters) and ‘host’ (local) jurisdictions.”<sup>121</sup>

- There have been no structures and European rules/laws in place to avoid:
- national responses to failing banks, although these responses/measures can have cross border consequences;
- last minute improvised coordination;
- case-by-case intervention and saving one bank at a time;
- high leverage among the internationally active large banks in Europe and the lack of capital(isation) i.e. if one bank defaults, it has high risks for other banks;
- lack of political will to act together in times of crisis and beforehand.

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<sup>115</sup> K. Lannoo, “The crisis, one year on”, CEPS Commentary, 7 August 2008, <[http://shop.ceps.eu/BookDetail.php?item\\_id=1690](http://shop.ceps.eu/BookDetail.php?item_id=1690)>:

<sup>116</sup> Interinstitutional Monitoring Group, Final report monitoring the Lamfalussy process, Brussels, 15 October 2007, p.19-20.

<sup>117</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>118</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>119</sup> quote from L. Pauly, “Political Authority and Global Finance: Crisis Prevention in Europe and Beyond”, Global Economic Governance Working Paper WP 2007/34, Oxford University, May 2007, mentioned in N. Véron, Is Europe ready for a major banking crisis?, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

<sup>120</sup> L. Pauly, “Financial crisis management in Europe and Beyond”, Political Economy, issue 27, 2008 p. 84.

<sup>121</sup> N. Véron, “Is Europe ready for a major banking crisis?”, Bruegel policy brief, Issue 2007/03, August 2007, <[http://www.bruegel.org/Public/Scholars\\_Publications.php?ID=1167&contactID=2066](http://www.bruegel.org/Public/Scholars_Publications.php?ID=1167&contactID=2066)>

The question remains whether the many failures and weaknesses in the European financial architecture that have been revealed by the financial crisis can be sufficiently rectified and a re-orientation of the financial sector introduced in order to avoid future financial and economic crises. The opaque existing processes and structures to which vested interests have good access, and the member states continued willingness to defend the competitiveness of their financial sector, may cast doubts over whether a full restructuring of the financial sector will take place in the short run.

## CHAPTER 5: EU REPRESENTATION IN INTERNATIONAL FINANCIAL INSTITUTIONS AND TRADE NEGOTIATIONS

The Commission's Directorate-General for Economic and Financial Affairs is responsible for the Commission's presence in the multilateral economic and international financial institutions as described below. Also regarding development policy, the Commissioner for Economic and Monetary Affairs is in charge of coordination with international financial institutions.

The Economic and Financial Committee (EFC) who advises at the Council is responsible for coordinating between member states and different international financial institutions.

Apart from where mentioned below, the European Commission participates in the following international financial standard setting bodies in which some but not all member states participate, such as: the Basel Committee on Banking Supervision (BCBS)<sup>122</sup>, the Banking Supervision Committee of the European Central Bank and the Joint Forum on Financial Conglomerates<sup>123</sup>, and the International Association of Insurance Supervisors (IAIS)<sup>124</sup>. The commission is an observer at the International Financial Reporting Interpretations Committee (IFRIC: which develops guidance to promote consistent practice of standards developed by the International Accounting Standards Board (IASB))<sup>125</sup>.

The European Central Bank participates in the following standard setting body: the Committee on Payment and Settlement Systems (CPSS)<sup>126</sup>.

None of the EU institutions participate in the following international financial standard setting bodies, although some member states do: Committee on the Global Financial System (CGFS)<sup>127</sup> and the International Organisation of Securities Commissions (IOSCO)<sup>128</sup>.

Where the Commission is not represented, it has expressed its dissatisfaction with this external representation of the EU and its lack of a single view and voice.<sup>129</sup>

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<sup>122</sup> [http://ec.europa.eu/internal\\_market/bank/index\\_en.htm](http://ec.europa.eu/internal_market/bank/index_en.htm); <http://www.bis.org/about/factbcbs.htm>: does not mention the EC participation

<sup>123</sup> [http://ec.europa.eu/internal\\_market/bank/index\\_en.htm](http://ec.europa.eu/internal_market/bank/index_en.htm)

<sup>124</sup> <http://www.iaisweb.org/index.cfm?pageID=31>

<sup>125</sup> <http://www.iasb.org/About+Us/About+the+IFRIC/IFRIC+members.htm>

<sup>126</sup> <http://www.bis.org/about/factcpss.htm>

<sup>127</sup> <http://www.bis.org/about/factcgfs.htm>

<sup>128</sup> <http://www.iosco.org>

In addition, the Commission develops bilateral relations in the financial field, apart from trade agreements in which financial services and capital are being liberalised. The Commission's Directorate-General for Economic and Financial Affairs leads “negotiations and regular dialogues on the economic aspects of bilateral relations, for example with China, India, Japan, Russia, South Africa, the US, EU candidate countries and EU Neighbourhood Countries”.<sup>130</sup> “On external relations, the Commission [DG Markt]<sup>131</sup> has developed a strategy for a coherent and strengthened EU policy in the field of financial services. Work focuses in particular on taking forward the regulatory or other dialogues with the EU's main trading partners, namely the United States (in the context of the EU-US Financial Market Dialogue) and Japan, but also the emerging financial services markets in China, India, Russia and elsewhere”<sup>132</sup>.

## 5.1. EUROPEAN REPRESENTATION AT INTERNATIONAL FINANCIAL INSTITUTIONS

The EU and its member states are represented in different ways at the following institutions and fora that deal with financial stability, financial markets and financial services

### **International Monetary Fund (IMF)**

According to the Commission<sup>133</sup>, the EU is represented at the IMF by its member states. The EU member states prepare the IMF meetings during the ECOFIN (informal) meetings.<sup>134</sup> However, the Commissioner for Economic and Monetary Affairs participates in the annual and spring meetings of the IMF and the World Bank on behalf of the European Commission. The European Commission participates as an observer in the IMF's governing bodies (the International Monetary and Financial Committee and the Development Committee).

The EU Member States coordinate their positions at the IMF in Brussels at the Economic and Financial Committee meetings and in Washington where the group of EU representatives to the IMF (so-called EURIMF) meets regularly. Because coordination remains unsatisfactory, an improvement was made in 2007 by electing a chairman of the EURIMF for a two year term. It is planned to appoint a Commission official in the office of one of the euro-area's Executive Directors, which should lead to a stronger and more influential voice for Europe within the IMF.<sup>135</sup>

### **World Bank**

The Commissioner for Economic and Monetary Affairs is in charge of coordinating relations of the EU and its member states with the World Bank to ensure a consistent approach towards

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<sup>129</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_economic\\_issues200\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_economic_issues200_en.htm): “In view of the euro's global reach, the euro area has an increased responsibility with respect to the stability of the global economy. This makes it important for the euro area to present a single view when contributing to international governance. The Commission has long been advocating better coordination to ensure an effective external representation of the euro area in international economic and financial institutions and forums. The Commission, as well as most of its EU and international partners, considers that in the long term, a unified or single representation would be the best way for the euro area to play a role commensurate with its economic weight in the international economic and financial sphere.”

<sup>130</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/index\\_en.htm?cs\\_mid=251](http://ec.europa.eu/economy_finance/int_economic_issues/index_en.htm?cs_mid=251)

<sup>131</sup> [http://ec.europa.eu/internal\\_market/bank/index\\_en.htm](http://ec.europa.eu/internal_market/bank/index_en.htm)

<sup>132</sup> [http://ec.europa.eu/internal\\_market/finances/index\\_en.htm](http://ec.europa.eu/internal_market/finances/index_en.htm)

<sup>133</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_economic\\_issues200\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_economic_issues200_en.htm)

<sup>134</sup> ECOFIN press release, 7 October 2008, p. 23: the discussion was done during a breakfast meeting, <[http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ecofin/103250.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/103250.pdf)>

<sup>135</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_institutions\\_and\\_fora262\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_institutions_and_fora262_en.htm)

developing countries. The European Union is represented at the World Bank by its member states. The EU member states prepare the World Bank meetings among themselves among others during the ECOFIN (informal) meetings.<sup>136</sup>

The commissioner for Economic and Monetary Affairs takes part, as an observer, in the Development Committee of the World Bank, while the Commissioner for Development and Humanitarian Assistance acts as his stand-in. The Commission follows the discussions on, and the implementation of, the international debt strategy, in particular in light of the substantial contribution of the European Community to the debt initiative for highly indebted poor countries (HIPC). In addition, Sub-Saharan Africa is a commonly focused priority, and cooperation between the Commission and the World Bank is seen as playing an important role in the Mediterranean region.

Along with the EIB and other international financial institutions, the World Bank participates in the different Memoranda of Understanding managed by the Commission for the Mediterranean region. The Community is a large donor to World Bank Trust Funds with contributions amounting to nearly €0.5 billion per year.

### **G-7/G-8**

Of the Group of 7 major economic powers (G-7), four are belonging to the EU: France, Italy, Germany, and the UK. The EU member countries prepare G-7 meetings among themselves (informally) during the monthly ECOFIN meetings, in which the EFC plays a role.

The European Commission President is a full G-8 member. Therefore, when the G-8 finance ministers meet before the actual G-8 summit, both the Commission and Russia attend.

The finance ministers also meet three more times (in general early in the year, and at the margin of the spring and annual meetings of the international financial institutions) in a G-7 (not G-8 framework) framework. Within this framework, the Commission and Russia are only called in for some specific agenda points and the President of the Eurogroup also attends parts of the meeting.

The European Central Bank (ECB) participates at the entirety of the G-7 meetings, among others because of the introduction of the Euro.

Because the G-7 deals with many issues in which the Community has a competence, either exclusive or shared with its member states, and because of the EU's economic importance and the Euro, the Commission wants to fully participate in the G-7 finance ministers' meeting, and wants the Union including the Commission to be associated with the entire G-7 process.<sup>137</sup>

On 5 October 2008, when many banks and financial markets of the EU countries were being severely hit, the French Presidency called an informal meeting of the European members of the G-7 in order to prepare a G-7 finance minister meeting some days later. The meeting produced a statement with some principles and measures, some of which were not really honoured – such as the promise to act in a coordinated way - and some of which were already in the making or discussed at EU level – such as diminishing undue executive pay and improving capital requirements. This unprecedented gathering of a selected group of heads of state to deal with financial markets was being criticized by other member states that feared they would be excluded from decision-making.

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<sup>136</sup> ECOFIN press release, 7 October 2008, p. 23: the discussion was done during a breakfast meeting, <[http://www.consilium.europa.eu/ueDocs/cms\\_Data/docs/pressData/en/ecofin/103250.pdf](http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/103250.pdf)>

<sup>137</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_institutions\\_and\\_fora202\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_institutions_and_fora202_en.htm)

Others argued that at least something was being done by the French presidency since not much coordination existed at EU level ... except that ECOFIN would meet during the next days.

Since 2005, the G-8 has been holding dialogues with the major emerging economies of Brazil, China, India, Mexico and South Africa.

### **The Financial Stability Forum (FSF)**

After the Asian crisis (in 1999), the Financial Stability Forum was created to analyse vulnerabilities in the financial sector, promote international financial stability and international co-operation in financial supervision, and identify adequate policy responses, including regulations.

Only a selected group of 12 countries participates in the FSF, among others from the EU: France, Germany, Italy, the Netherlands, and the UK. Different international financial regulatory or supervisory bodies participate in the FSF, including the ECB.<sup>138</sup> Only two 'developing countries' are so far member of the FSF, Hong Kong and Singapore. The international meeting on financial stability and the reform of the international financial architecture, called Bretton Woods, that gathered the G-20 countries (see below) on 15 November 2008, has announced that more countries would be part of the FSF without mentioning who and how.

The Commission does not participate in the FSF although the Commission plays a role in regulating the Union's financial services.

The FSF is often being mentioned in ECOFIN meeting documents as being the organisation which gives guidance to ECOFIN on financial stability issues and in which the EU member states participate.

### **G-20**

The G-20 is an informal forum, established in the late 1990s, for discussion between industrial and emerging-market countries on global economic stability issues. Behind the background of the crisis and the reconfiguration of the international system and economic powers, there is a trend to make the G-20 the leading governance body for setting up a new financial architecture and to replace the G-8.

The members of the G-20 are the finance ministers and central bank governors of 19 countries of which France, Germany, Italy, and the United Kingdom are EU member states and G-7 members. Other important developing country members are: Argentina, Brazil, China, India, Indonesia, Mexico, Saudi Arabia and South Africa.

The European Union is a member of the G-20 and represented by the rotating Council presidency and the European Central Bank.

"The European Commission's representation in the G-20 is limited. It participates in the meetings at deputies' level and in the workshops as part of the EU Presidency delegation. It is excluded from the G-20 ministerial meeting."<sup>139</sup>

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<sup>138</sup> <http://www.fsforum.org/members/links.htm>

<sup>139</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_institutions\\_and\\_fora202\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_institutions_and_fora202_en.htm): "The G20 exerts significant and growing influence in areas where the Community's competence exists and where strategic interests of the EU are at stake, such as multilateral trade issues, regional integration, financing for development, combating the financing of terrorism or exchange-rate issues." ... "Commission participation in this meeting, as part of the EU delegation, would improve G20 effectiveness. The full association of the Commission to the G20 is warranted because it is entrusted with the representation of EU members in some key policies and prepares and enforces legislation or steers Member States' co-operation in areas of interest to the G20."

In the case that the increasing role of the G-20 is confirmed in the future, the minor status of the EU in that body would be an additional limitation for its influence.

### **Multilateral Development Banks**

The European Community is not formally represented in most of the regional development banks (the African Development Bank, Asian Development Bank and Inter-American Development Bank), although their membership includes some EU countries. The European Community is, however, represented in the European Bank for Reconstruction and Development (EBRD) where it is a shareholder.

### **The Organisation of Economic Cooperation and Development (OECD)**

The OECD has a Committee on Financial Markets (with a Working Party on Financial Statistics and one on Debt Management) and an Insurance and Private Pensions Committee, which are both being serviced by the OECD Directorate for Financial and Enterprise Affairs. The OECD Economics department deals with many monetary and financial issues.

“European Commission has the right to take part in the work of the OECD, enjoying all the rights of membership, except the right to vote. The Commissioner in charge of Economic and Monetary Affairs attends the economic part of the OECD ministerial meetings.”<sup>140</sup>

## **5.2. LIBERALISATION OF FINANCIAL SERVICES IN THE WORLD TRADE ORGANISATION AND FREE TRADE AGREEMENTS**

DG Trade is responsible for negotiating trade and investment agreements that include liberalisation of trade and investment in financial services. In free trade agreements with developing countries, such agreements include rules that prohibit limits of movement of capital.

DG Trade has the right for proposing a trade negotiation mandate, which is then agreed by the Council, after preparation in the Financial Services Committee. DG Trade negotiates on behalf of the Community and the Union member states, which are consulted during the negotiations at the 133 Committee. The European parliament is only informed during the course of the negotiations. The Council concludes a trade agreement after the negotiations are over and gives the mandate to sign an agreement, before the ratification procedure starts. Depending on the scope of the agreement, the European Parliament and the parliaments of the member states have to ratify the free trade agreement.

Financial services is a key target sector of the EU and the EC during free trade negotiations at the World Trade Organisation (WTO) level under the General Agreement on Tariffs and Trade (GATS), and during the free trade agreements (FTAs). It is a result of the Lisbon strategy and the DG Trade policy of “Global Europe, competing in the world” because the European conglomerates are considered to be competitive and in need of new markets to continue or expand their profitability.

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<sup>140</sup> [http://ec.europa.eu/economy\\_finance/int\\_economic\\_issues/int\\_economic\\_issues200\\_en.htm](http://ec.europa.eu/economy_finance/int_economic_issues/int_economic_issues200_en.htm)

### **Financial services negotiations in GATS**

During GATS negotiations, WTO member states have the choice whether to make ‘commitments’ to liberalise their financial services. They are however put under pressure to do so during secret bilateral negotiations (as part of the GATS negotiation process) to liberalise. The EC has been requesting many developing countries to liberalise financial services and several developing countries have indicated they are willing to liberalise further.<sup>141</sup> But only after the whole round of WTO negotiations – which also include liberalisation of agricultural and industrial goods according to the Doha agenda - is finalised will it be clear which country has liberalised what.

GATS not only opens up markets but also restricts regulation. Although the GATS Annex on financial services (Art. 2) allows authorities to take prudential measures to protect customers and avoid financial instability or ensure the integrity of the financial sector, the question is which prudential measures will be seen as acceptable and which not. However, this GATS ‘prudential carve out’ stipulates that prudential measures should not undermine GATS commitments - which is difficult to assess and might have prevented some governments in the past from implementing particular prudential regulations. Countries could use GATS article XIV that allows them not to implement their commitments arguing that public health is at stake, but WTO members are afraid to use that article for fear that it would be too difficult to prove or that Article XIV would be abused to their disadvantage in the future.

Countries that have fully liberalised under GATS or FTAs with the EU, without attaching conditions or exceptions, face the following problems that increase financial instability and restrict authorities from intervening to prevent or deal with instability in financial markets:

- **Liberalisation of risky and unstable financial services**

When WTO members liberalise and make specific liberalisation ‘commitments’ (special lists annexed to the GATS agreement), they can liberalise financial services sub-sectors including trading in risky, speculative and unregulated financial products such as securities, exchange rate swaps and derivatives, as well as for instance private pension management and trust services (often used for tax evasion).

Once a WTO member has fully liberalised a financial sector or sub-sector under GATS, this ‘commitment’ is very difficult to reverse i.e. the government cannot prohibit and stop a foreign service provider from entering the country and offering financial services that have been committed.

- **Deregulation rather than securing proper regulation**

Once WTO members have made commitments in financial services, they are subject to some particular GATS rules that restrict how governments can regulate and deal with foreign financial service companies, except if they make written exemptions to some of these rules in their GATS commitments lists. GATS rules include the national treatment principle by which foreign investors should not be treated less equal than national investors (but it is allowed to treat foreign investors better!). Also, GATS ‘market access’ rule prohibits restrictions for instance on the number or value of financial services operations as well as restrictions on foreign ownership of banks, insurance companies etc. The latter means that mergers & acquisitions and 100% foreign ownership are to be allowed. Such GATS rules leads to a global finance industry that becomes too big to fail since there are no proper international financial supervision or competition authorities.

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<sup>141</sup> Since these negotiations are secret, not much information is lately available but offers to further liberalise can be analysed from the list of publically available offers at [http://docsonline.wto.org/imrd/gen\\_searchResult.asp?RN=0&searchtype=browse&q1=%28+%40meta%5FSymbol+TN%FCS%FCO%FC%2A+and+rev%2E1+%29+&language=1](http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=%28+%40meta%5FSymbol+TN%FCS%FCO%FC%2A+and+rev%2E1+%29+&language=1)



- **Attacking prudential regulations**

In addition, during the secret GATS negotiations on further liberalisation of financial services, industrialised countries are requesting that developing countries remove financial prudential regulations. For instance, the EU had requested in 2002 to remove host country requirements that foreign banks keep money reserves in the host country. This was based on demands from the European financial industry that wished to be able to move around financial reserves to make the most profit out of it. This contrasts with the many calls to increase capital reserves at banks since the financial crisis started in 2007. There are many other prudential regulations which were introduced after the Asian crisis which the EU requested in 2002 to be removed.<sup>142</sup>

- **Uncontrolled liberalisation**

The **GATS Understanding on Commitments in Financial Services** is a model of broad and quick liberalisation of a large range of financial sub-sectors and is being implemented by mostly industrialised countries. More advanced developing countries have been asked to liberalise according to this model in the Doha Round. It results in uncontrolled liberalisation of financial service providers and financial services by requiring among others:

- to permit that foreign financial service suppliers can offer **any new financial service**;
- to remove any obstacle to foreign financial services that remains even if all the provisions of the GATS agreement have been respected.

- **GATS liberalises capital flows**

GATS rules prohibits that restrictions are introduced on international payments for current transactions when financial services are committed.<sup>143</sup> Restrictions on such current capital flows can only be made in case of balance of payment problems (Art. XII) and after many conditions have been respected. In addition, when a country has made commitments in particular financial sectors regarding their cross border movement and establishment, it has to allow the cross-border movement of capital, which is essential to those committed services.<sup>144</sup> In the financial sector, this can result in movements of huge amounts of capital in or out of the country, but which cannot be controlled by the national authorities.

**The free trade agreements (FTAs) result in more unrestricted capital flows and financial services**

During FTA negotiations, the financial services sector is a major target of the EU to achieve liberalisation. This is apparent in the many articles on liberalisation of financial services in the FTAs the EU has signed with Chile and Mexico.

The EU is currently negotiating free trade agreements with developing countries which cover liberalisation of trade and investment in financial services. These negotiations are based on a model framework proposed by the EC. The model has been very much reflected in the case of the EU's FTA negotiations with ACP countries in the Economic Partnership Agreements (EPAs). The result

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<sup>142</sup> Myriam Vander Stichele, GATS negotiations in financial services: The EU requests and their implications for developing countries, 1 and 3 December 2005.

<sup>143</sup> Art. XI to GATS: also applies to any services sector whose liberalization is being committed under the GATS agreement.

<sup>144</sup> Art. XVI, footnote 8: also applies to any services sector whose liberalization is being committed under the GATS agreement.

has been a 'GATS plus plus' format, as can be seen in the EPA signed between the EU and the Caribbean group (i.e. Cariforum States) while the other African and Pacific countries have not yet finalised the EPA negotiations on services and investment.

The 'GATS plus plus' format is based on:

- GATS Art. V, by which developing countries have to make quite substantial liberalisation commitments,
- the inclusion in EPAs of elements that are not yet decided in the GATS negotiations or even elements that have been rejected in GATS negotiations.

The Caribbean EPA contains far reaching, sometimes modified<sup>145</sup>, elements of the GATS Annex on financial services and the GATS Understanding on Commitments in Financial Services (see above).

During current FTA negotiations, the EU tries to introduce obligations on authorities to implement international financial stability standards – an attempt which the Caribbean negotiators refused because they were not part in the decision-making of those standards. The many international standards which the EU wants to include in FTAs were hardly negotiated by developing countries, namely:

- the Basel Committee's "Core Principle for Effective Banking Supervision",
  - the International Association of Insurance Supervisors' "Insurance Core Principles",
  - the International Organisation of Securities Commissions' "Objectives and Principles of Securities Regulation",
  - the OECD's "Agreement on exchange of information on tax matters",
  - the G-20 "Statement on Transparency and exchange of information for tax purposes",
  - the Financial Action Task Force's "Forty Recommendations on Money Laundering",
  - the "Nine Special recommendations on Terrorist Financing", and
  - the Parties had also to take note of the "Ten Key Principles for Information Exchange" promulgated by the Finance Ministers of the G-7 Nations, and to take all steps necessary to try to apply them in their bilateral contacts
- **Restrictions to control capital flows**

A very important aspect of the FTAs such as the Caribbean EPA is that it restricts even further the authorities' capacity to control capital flows. The rules go beyond what is being agreed in the GATS, which already prohibits restrictions on all payments for **current** transactions in sectors which have been liberalised under GATS. The Caribbean EPA also goes further than what the Cotonou Agreement states about capital movements. However the Caribbean EPA -which is based on the model for all FTAs the EU is currently negotiating - goes further to:

- prohibit restrictions on all payments for current transactions **between residents** of the signatory countries (rather than only related to foreign investments),
- prohibit restrictions on the free movement of capital relating to direct investments with regard to transactions on **the capital account** of balance of payments,

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<sup>145</sup> For instance the rule in the Caribbean EPA on introducing new financial services is somewhat more nuanced than the GATS and stipulates: Each Party shall permit a financial service supplier of the other Party to provide any new financial service of a type similar to those services that the Party permits its own financial service suppliers to provide under its domestic law in like circumstances. A Party may determine the juridical form ... a decision shall be made within a reasonable time the authorisation may only be refused for prudential reasons is required

- require that measures ensuring the **integrity and stability** of a Party's financial system shall not be more burdensome than necessary to achieve their aim, and shall not discriminate against financial service suppliers of the other Party in comparison to its own like financial service suppliers,
- limit the way safeguard measures with regards to capital movements can be taken: only “**in exceptional circumstances**” when payments and capital movements between the Parties cause or threaten to cause serious difficulties for the operation of monetary policy or exchange rate policy in one or more [signatory States]; and only those safeguard measures with regard to capital movements “that are **strictly necessary** may be taken” for a period not exceeding six months

Such rules prohibit countries to have the necessary flexibility to prevent a financial crisis or to act during times of financial crisis to protect the financial and other needs of the society of the host country. There are some provisions to deal with balance of payments problems, but these are made conditional.<sup>146</sup>

- **Lack of protection for consumers**

The losses by savers at the Icesave bank in the UK and in the Netherlands has made clear that consumers cannot be sure anymore whether foreign banks established in their country are safe. Icesave was a branch of Landsbanki from Iceland. Iceland was part of a free trade agreement – the European Economic Area (EEA) with the EU. Once a country has liberalised under GATS or a free trade agreement, foreign banks have the right to establish branches in that country but savers' interests are not taken into account. For instance, the host country supervisor is dependent on information of the supervisor in the home country to see whether the branch is stable and meeting conditions set by the host supervisor. This system failed in the case of Icesave and the host supervisor had too little information to take measures to protect Icesave's customers.

The Commission has been criticised by NGOs for not taking a development approach in its services trade and investment negotiations in EPAs and FTAs. However, the Commission (DG Trade, DG Development) considers that investment by foreign service providers and not in the least, foreign banks and insurance companies, will increase the effectiveness on developing countries' economies. How the coherence between development and trade/financial sector liberalization is worked out in the EU's Coherence for Development paper needs further analysis.

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<sup>146</sup> See the Caribbean – EU EPA: Part VI - General And Final Provisions

## CHAPTER 6: THE IMPACT ON DEVELOPING COUNTRIES

Developing countries experience major impacts from EU policies on liberalisation of financial services and capital movements through the EU's position in GATS and FTA negotiations. The EU's Lisbon agenda to make European companies competitive in the world has been translated in aggressive negotiations in the WTO and in free trade agreements, including EPAs, to open up financial services sectors as much as possible in developing countries, and to remove particular prudential measures of host countries and constraints on capital movements.

DG Trade does not assess whether there is enough regulatory and supervisory capacity in the targeted developing countries. During the current crisis, the risks of instability that such liberalisation negotiations can entail are becoming more visible. Developing countries in which domestic banks have been taken over by European, and US, banks can now have problematic banks within their borders whose lead home supervisors have little concerns about developing countries. Amongst others, foreign banks in problems are very likely to provide less credit to domestic producers in developing countries, as this is already the case in the European home countries of the troubled banks. Weak regulations and supervision resulted in too high leverage and lack of capitalisation at the internationally active large European banks.

### **Recommendations:**

The EU, and especially DG Trade, should be told by the member states not to make any further demands during the current GATS and FTA negotiations to liberalise financial services and capital movements.

The EU should allow countries to roll back their liberalisation commitments when they are not accompanied by efficient regulation and supervision.

Developing countries are also affected through the impact of the recession that is following the financial crash. Negative consequences stemming from the financial crisis, lack of trust, pro-cyclical behaviour of the ECB (in particular the rising of the interest rate in summer 2008) etc., are amongst others:

- Increased interest rates for lending to developing countries (governments, companies, trading activities);
- less credit to and no inter-bank lending including to banks of developing countries;
- less exports to the EU from developing countries due to economic recession.

The crisis in developed countries has also a positive impact: the Anglo-Saxon model of liberalised financial markets and liberalised entry of foreign banks or other private financial services providers, whereby the markets were supposed to stabilise themselves, has clearly shown not to be working. Pressure to introduce or maintain such models should in principle decrease (which does not seem the case at the IMF), or at least developing countries can more easily argue against them. Especially since China, which still has state control over its financial sector, is considered to be more successful.

### **Recommendations:**

The EU should promote the participation of much more developing countries in international standards setting bodies and the international fora dealing with the restructuring of the

international financial sector, so that the interests of these countries are being heard and taken into account.

The lack of effective regulation and supervision at EU and European national level also resulted in problems that developing countries faced when there was no financial crisis such as:

- unregulated rating agencies that had conflict of interests when rating governments and companies in developing countries, or had little interest in rating them;
- unregulated private equity and hedge funds, with loans from Western banks, started to lure capital from rich people in developing countries and to buy up companies with operations in the South with a view to make short term profits;
- lack of cooperation and information sharing among supervisors from host and home countries, which deprives host countries to have an insight of (cross-border) capital flows by foreign financial service providers.

The lack of a unified voice at international financial forums also makes it difficult for developing countries to deal with EU member states.

**Recommendations:**

When discussing new ways to supervise cross-border EU financial conglomerates, instruments need to be taken into consideration to protect the interests of developing countries that are hosting European banks. In general, all European and international financial measures should be assessed so as to avoid negative impacts on developing countries, especially those where European banks and insurance companies are established.

Special measures that support developing countries in more difficult times due the financial and economic crisis should be put in place.

The EU should not support Export Credit Agencies in the financial industry that creates more debt as diagnosed by the WTO.<sup>147</sup>

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<sup>147</sup> “Experts discuss problems of trade finance”, WTO press release, 2 November 2008, <[http://www.wto.org/english/news\\_e/news08\\_e/trade\\_finance\\_12nov08\\_e.htm](http://www.wto.org/english/news_e/news08_e/trade_finance_12nov08_e.htm)>

# CONCLUSIONS

The European Commission and the member states are both important when it comes to EU-level regulation. DG Markt of the Commission is particularly important since it has the right to initiate draft proposals for directives to be co-decided by the Council and the European Parliament. The wide-ranging consultation mechanisms that are dominated by the financial industry make it difficult for voices from other stakeholders, such as consumer groups or NGOs to be heard.

Member state representatives influence DG Markt before a directive is proposed, through the Lamfalussy process and by deciding on roadmaps of measures to be taken. The ECOFIN meetings are also important moments since they are ultimately co-decide whether directives are adopted.

To influence the Council, contacting the national representatives at Economic and Financial Committee and the Financial Services Committee is important. Another way to target EU level discussions and decisions is to approach EU member country representatives at the Level 2 and Level 3 Committees of the Lamfalussy process and those sitting at the ECB.

The European Parliament has limited influence to get DG Markt to take up an issue which the Commissioner does not like, but its influence is considered to be growing.

Given that member states still have competence on supervision, and given the lack of coordinated supervision at EU level and the continued influence of Anglo-Saxon thinking and vested interests, it remains important to discuss regulatory and supervisory issues with the relevant national supervisors, central banks and regulators (Ministries of Finance, parliaments). This means starting discussions with and setting up dialogues with national Central Banks and other supervisory bodies at national level, and their representatives at international level. The central bankers might get a more important role in the future but, so far, they have had little dialogue or other connections with civil society organizations.

As long as the internal contradictions in the EU remain, common regulatory and supervisory policies are unlikely to have substantial impact. The co-existence of the Euro zone and the non Euro countries, the tremendous political weight of the finance industry in the UK, the historically deep rooted differences in the financial “culture”, the determined ideological opposition to regulation in the new member states together with the general crisis of integration of the union make radical and systemic changes rather unlikely to happen in the short-term.

On the other hand the internal governance crises and the slow down of the integration process of the EU could deepen to the point of offering the political opportunity for rethinking the basic orientation of the EU and promoting a more equitable, environmentally sound, peaceful and development friendly process of integration. In this context European civil society should get ready since now in developing this alternative vision starting with reclaiming public interest in financial policies moved by European Member States and the EU as a whole, and questioning the lack of accountability for existing fragmented processes and institutions, including the ECB.

Therefore, the present crisis may effect some change. Some of the worst weaknesses, such as lack of regulation of credit rating agencies and too lax capital requirements, are being tackled in the short term. At the same time the definition on new directives dealing with financial markets related issues will offer the opportunity to engage in the European arena for raising all those critical issues deriving from financial liberalisation which are not under discussion now.

In this context, civil society should evaluate where to invest its resources in shadowing the EU in this field. There is a need for permanent monitoring, but mobilisation to deal with inefficient and fragmented policy is limited so far. Exposing the lobby of the financial industry is one way to create countervailing powers. Focussing on particular issues of interest to developing countries and create a more sustainable and equitable financial system at all levels will be necessary.

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## ANNEXES

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### ANNEX I: MAIN ACTIONS PROPOSED AS A CONCLUSION OF THE EVALUATION OF THE LAMFALUSSY PROCESS BY THE COMMUNICATION<sup>148</sup>

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GENERAL			
	Abolition of sunset clauses in financial services legislation	European Parliament, Council	End 2007
	Publication of study on costs of compliance	Commission	1 <sup>st</sup> half 2009
ADOPTION OF LEGISLATION – LEVELS 1 AND 2			
	Future alignment of transposition deadlines for directives and implementing measures	Commission, European Parliament, Council	Ongoing
	Extension of impact assessment to implementing measures	Commission	Ongoing
	Impact assessments for any substantive amendments in the legislative process and the technical advice by the Level 3 Committees	Council, Level 3 Committees	Ongoing
	Limitation of any regulatory additions ("goldplating) and obligation to justify to the Commission	Member States	Ongoing
	Systematic publication of responses to consultation and summary reports of hearings organised as part of consultations on the internet	Commission, Level 3 Committees	Ongoing
SUPERVISORY COOPERATION AND CONVERGENCE – LEVEL 3			
	Adoption of political statement indicating the main achievements expected from the Level 3 Committees	Commission, European Parliament, Council	Starting in 2008
	Regular reporting on the achievement of these objectives	Level 3 Committees	Starting in 2008
	Inclusion of the requirement to cooperate with other supervisors at European level in the constitutive charters of national supervisors	Member States / Commission	1 <sup>st</sup> half 2008
	Reinforcement of the legal status of the Level 3 Committees (possible modification of Commission decisions setting up the three Level 3 Committees / changes in framework Level 1 legislation)	Commission, European Parliament , Council	2008
	Extension of the qualified majority voting in decision-making of the Level 3 Committees	Level 3 Committees / Commission	1 <sup>st</sup> half 2008
	Political commitment to the full application of Level 3 common standards and guidelines	Level 3 Committees, Member States	
	Cross-sectoral survey on supervisory powers and systems of sanctions and assessment of the need to reinforce the provisions on minimum supervisory powers in the framework	Commission	End 2008

<sup>148</sup> Source: Review of the Lamfalussy process Strengthening supervisory convergence - Communication from the Commission, (COM(2007) 727 final)

	legislation		
	Political debate on operational independence of national supervisors	Commission / Member States	1 <sup>st</sup> half 2008
	Introduction of explicit legal provisions in financial services directives to allow supervisors to delegate tasks to another Member State's supervisor	European Parliament, Council, Commission	End 2008
	Legislative proposal to strengthen the powers of the 'lead' supervisor for cross-border banking groups	Commission	October 2008
	Development of a set for common standards for the operation of the colleges for cross border operations	Level 3 Committees	1 <sup>st</sup> half 2008
	Report on the development of common reporting standards	Level 3 Committees	End 2007
	Decision on possibility and modalities of contributing to the financing of Level 3 Committees	Commission	End 2008

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**ANNEX II: CONSULTATIONS ON LINE BY DG MARKT (INTERNAL  
MARKET AND SERVICES)**

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Title & description	Policy activity	Target group	Closing date
Consultation by the Commission services on Credit Rating Agencies (CRAs)	Securities	Stakeholders	05.09.2008
Second consultation: potential refinements to the Capital Requirements Directive	Banking	Stakeholders	18.07.2008
Review of Decisions establishing the Committees of Supervisors	Financial services	Stakeholders	18.07.2008
Public Consultation on insurance guarantee schemes	Insurance	Stakeholders	07.07.2008
Potential refinements to the Capital Requirements Directive	Banking	Stakeholders	16.06.2008
Services protected by conditional-access systems	Media	Stakeholders	04.04.2008
Public Consultation on Solvency II and QIS4	Insurance	Stakeholders	15.02.2008
"Substitute" retail investment products	Financial Services	Stakeholders	18.01.2008
European Private Company Statute	Company law	Stakeholders	31.10.2007
Reorganisation and winding-up of credit institutions	Banking	Stakeholders	30.09.2007
Quality of Services - Codes of conduct	Services Directive	Stakeholders	15.08.2007
Minimum standards that should apply to shareholders' rights	Corporate Governance	Stakeholders	27.07.2007
Green Paper on Retail Financial Services in the Single Market	Retail financial services	Stakeholders	16.07.2007
Storage of regulated information	Securities and Investment Funds	Stakeholders	02.04.2007
Commission consults on possible reform of liability rules in the EU	Auditing	Stakeholders	15.03.2007
Relations with third countries	Auditing	Stakeholders	05.03.2007
Public Consultation on Solvency II	Insurance	Stakeholders	23.03.2007
Consultation on the report of the Mortgage Industry and Consumer Dialogue	Retail financial services	Stakeholders	15.02.2007
Consultation on the report of the Mortgage Funding Expert Group	Retail financial services	Stakeholders	15.02.2007
2006			
Consultation on follow-up study on "The possible introduction of an insurance against costs for litigation in patent cases"	Patents	Stakeholders	31.12.2006
Draft report on the continued appropriateness of the requirements for professional indemnity insurance imposed on intermediaries under	Investment services	Stakeholders	31.10.2006

Community law Recognition of professional qualifications concerning activities related to professional use, trade and distribution of toxic products	Regulated professions	Stakeholders	1.10.2006
Copyright levy reform	Copyright	Stakeholders	14.07.2006
Evaluation of Settlement Finality Directive	Financial Markets	Stakeholders	30.06.2006
Consultation on future Internal Market policy	Infrastructure Internal Market Strategy	Stakeholders	15.06.2006
Ten minutes to improve the business environment in the EU	General and institutional affairs	Stakeholders	June 2006
Motor Insurance: claims representatives and legal expenses insurance	Motor insurance	Stakeholders	05.06.2006
DG Internal Market and Services' working document on the amendment of Commission Regulation (EC) No. 809/2004 to include specific provision in respect of issuers with a complex financial history	Securities and Investment Funds	Stakeholders	19.05.2006
Revision of the Common Procurement Vocabulary (CPV)	Public Procurement	Stakeholders	31.05.2006
Consultation on how to improve supervisory approval process	Mergers and acquisitions in the financial sector	Stakeholders	19.04.2006
Consultation on future patent policy in Europe	Industrial Property	Stakeholders	12.04.2006
Consultation on future priorities for the Action Plan	Company law and corporate governance	Stakeholders	31.03.2006
Second DG Internal Market Services' Working document	Financial crime	Stakeholders	16.03.2006
Report on minimum guarantee level of Deposit Guarantee Schemes Directive 94/19/EC	Banking	Stakeholders	15.02.2006
Independent legal professionals and the prevention of money laundering Public consultation on Postal Services	Financial crime	Stakeholders	15.02.2006
Transparency Directive	Postal Services	Stakeholders	27.01.2006
Cross-border payments	Securities and Investment Funds	Stakeholders	08.01.2006
	Payment Services	Stakeholders	06.01.2006

2005

Title & description	Policy activity	Target group	Closing date
Green Paper on Mortgage Credit in the EU	Retail financial services	Stakeholders	30.11.2005
Green Paper on the enhancement of the EU framework for investment funds	Asset Management	Stakeholders	15.11.2005
E-money	Banking	Stakeholders	14.10.2005
Deposit Guarantee Schemes	Banking	Stakeholders	14.10.2005
Motor Insurance	Insurance	European citizens and all interested parties	15.07.2005
Minimum standards that should apply to shareholders' rights	Corporate Governance	Stakeholders	15.07.2005
Obstacles to cross-border mergers and acquisitions in the financial sector	Financial Services	Stakeholders	15.06.2005
Trading activities related issues and the treatment of double default effects	Financial Services	Stakeholders	27.05.2005
The application of the Lamfalussy process to EU securities markets legislation	Financial Services	Stakeholders	31.01.2005
Green Paper on Defence Procurement	Public procurement	Stakeholders	23.01.2005

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## ANNEX III: THE ACHIEVEMENTS OF THE LAMFALUSSY PROCESS

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By Autumn 2007<sup>149</sup>, the achievements of the Lamfalussy process resulting in actual EU legislation and implementation can be categorized as follows:

### (1) Securities

#### Level 1 "framework" legislation

- Directive of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (2004/39/EC)
- Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) (2003/6/EC)
- Directive of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (2003/71/EC)
- Directive of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (2004/109/EC)

#### Level 2 "implementing" legislation

- Commission Directive of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation (2003/124/EC)
- Commission Directive of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest (2003/125/EC)
- Commission Regulation of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments ((EC) No 2273/2003)
- Commission Directive of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions (2004/72/EC)
- Commission Regulation of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements ((EC) No 809/2004)
- Commission Directive of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation

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<sup>149</sup> Review of the Lamfalussy process Strengthening supervisory convergence - Communication from the Commission, (COM(2007) 727 final)

of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (2007/14/EC)

- Commission Directive of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (2006/73/EC)
- Commission Regulation of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive ((EC) No 1287/2006)

### **Level 3 measures**

- Stabilisation and Allotment – European Supervisory Approach; CESR/02-020b (9/4/2002)
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- CESR's guidelines to simplify the notification procedure of UCITS; CESR/06-120b (29/06/2006)
- CESR's Level 3 Guidelines and recommendations on Publication and Consolidation of markets data; CESR/07-043 (09/02/2007)
- CESR's Level 3 Recommendations on the List of minimum records under Article 51(3) of the MiFID Implementing Directive; CESR/06-552c (09/02/2007)
- CESR's guidelines concerning eligible assets for investment by UCITS; CESR/07-044 (19/03/2007)
- Guidelines - CESR Level 3 Guidelines on MiFID Transaction reporting; CESR/07-301 (29/05/2007)
- Recommendations - Inducements under MiFID; CESR/07-228b (29/05/2007)
- Q&A on Best Execution; CESR/07-320 (29/05/2007)
- Protocol on MiFID Passport Notifications; CESR/07-317 (29/05/2007)
- Recommendations - The passport under MiFID; CESR/07-337 (29/05/2007)



- Market Abuse Directive - Level 3 – second set of CESR guidance and information on the common operation of the Directive to the market; CESR/06-562b (12/07/2007)
- Guidelines - Level 3 guidelines on the classification of hedge fund indices as financial indice; CESR/07-434 (17/07/2007)

## **(2) Banking**

### **Level 3 measures**

- CEBS Guidelines on prudential filters for regulatory capital (21/12/2004)
- CEBS Guidelines on supervisory disclosure (1/11/2005)
- CEBS Guidelines on financial reporting (recast of 15/12/2006; amendments of 24 July 2007) (16/12/2005)
- CEBS Guidelines on common reporting (recast of 16/10/2006) (13/1/2006)
- CEBS Guidelines on the recognition of external credit assessment institutions (20/1/2006)
- CEBS Guidelines on supervisory review process (25/1/2006)
- CEBS Guidelines on supervisory cooperation for cross-border banking and investment firm groups (25/1/2006)
- CEBS Guidelines on validation (04/04/2006)
- CEBS technical guidelines on interest rate risk in the banking book (03/10/2006)
- CEBS Guidelines on outsourcing (14/12/2006)
- CEBS Additional technical guidelines on concentration risk (14/12/2006)
- CEBS Additional Guidelines on stress testing (14/12/2006)

## **(3) Insurance**

### **Level 3 measures**

- CEIOPS Guidelines for Coordination Committees in the Framework of the Insurance Groups Directive; CEIOPS-DOC-02/05 (February 2005)
- CEIOPS Recommendations regarding the Implications of the IAS/IFRS Introduction for the Prudential Supervision of Insurance Undertakings; CEIOPS-DOC-05/05 (September 2005)
- Statement on the Role of the Lead Supervisor; CEIOPS-DOC-07/06 (December 2006)