New institutions to control European economy: the EU financial reform perspectives

The on-going EU financial reform has led to the creation of several new financial institutions, alongside a European systematic risk board. The three new European financial watchdogs are formally in power from January 2011 with the idea of supervising financial activities: one for banks, second for securities and financial markets and, third for insurances and pensions. These "three plus one" components of the EU regulatory reform are deemed to provide more scrutiny to the European economic policies in the month and years to come.

During last three years the economic and financial crisis clearly highlighted the limits and drastic deficiencies of the European Union's previous financial-economic system of supervision. The reasons for deficiency were obvious; here are some of them: the accumulation of excessive risk was not detected, surveillance and supervision were not effective in time, the coordination between national authorities was far from optimal (when transnational financial institutions faced problems) and the number of these institutions was numerous and more than necessary. These were the reasons why both the member states and the European Commission decided to make a strategic regulatory reform including both the financial watchdogs and risk assessment authorities. Still, we have to remember that member states' politicians have been very slow in "beefing-up" financial market governance, due to its market nature and limited EU regulations. But that is all over, the EU leaders hope.

New institutions: ambitious tasks

Europe is learning from the crisis and the new institutions are supposed to provide an adequate response to the crisis' aftermath with a new system of surveillance and supervision. The main aim is to detect problems early and to act in time: in both coordinated and efficient way. These new structures are the controlling and supervising institutions for the adjusted financial sector in EU, argued the Commission (1).

With the new framework of financial supervision in Europe, the Commission is putting into effect some practical ideas delivered by the member states in 2010. Therefore, this framework is at the heart of the ongoing financial reforms. It is the foundation on which all other EU initiatives and reforms would be based, e.g. those for credit rating agencies, hedge funds, derivatives, stress tests, etc. At the same time, in accumulated form, these measures will enhance consumer protection while ensuring that the taxpayers are not bearing the costs of a crisis.

This move forward also demonstrates that the European Union, argued the Commission, was leading the way and upholding its international commitments. These new authorities will work with others across the world to ensure better global supervision.

Historically, the EU and the member states' efforts were quick and prompt. Already in September 2009 the Commission brought forward proposals to replace the EU's existing supervisory system with a **European system of financial supervisors (ESFS)** in order to:

- help restore business and markets' confidence in the financial sector;
- contribute to the development of a single rulebook for banking, markets and insurance;
- solve problems with cross-border firms in financial services, and
- prevent the build-up of risks that threaten the stability of the overall financial system.

On 22 September 2010, the European Parliament, after the consent from the EU-27 member states, agreed on the new supervisory framework proposed by the Commission; the decision was confirmed later by the ECOFIN Council's configuration on 17 November 2010. It is seen that two requirements have been necessary, i.e. the member states and the EP's decision in order to establish three European supervisory authorities (ESAs) and a European Systemic Risk Board (ESRB); they replaced from January 2011 the previously mal-functioning supervisory committees.

These institutions, argued the Commission, will not replace national authorities, as the EU's reform objective is not aimed at simple transferring the control of financial institutions to the EU. The aim is rather to create a network of authorities, where the national authorities are responsible for the daily surveillance, and the European authorities – using the expertise of the national authorities and working hand in hand with them – would be responsible for coordination, monitoring and, if need be, arbitration between national authorities. They would contribute to the harmonisation of technical rules applicable to financial institutions.

Early warnings

First, to be mentioned is the **European Systemic Risk Board** , ESRB which will monitor the entire European financial sector, while identifying potential problems which could contribute to a crisis in the future. The member states economic policies will come under more scrutiny through ESRB, which is deemed to prevent future crises (2).

ESRB is chaired by the ECB's President J-C.Trichet; it will work in close cooperation with the new European Supervisory Authorities; Mervyn King, governor of the Bank of England is appointed the ESRB's vice-chairman, in due respect to the British financial influence.

Other members of the board will be chosen from eminent European financial experts. The strong board's secretariat of about 20 members, will function from the ECB headquarters in Frankfurt and provide analytical research.

It is expected that the ESRB would "produce warnings" at an early stage when the member states are exposed to excessive current account deficit.

Integrated financial services market: new authorities

Since the start of 2011, the financial services sector in Europe is overseen at the EU level by **three committees with advisory powers**:

- **the Committee of European Banking Supervisors (CEBS)**
- **the Committee of European Insurance and Occupational Pensions Committee (CEIOPS)**
- **the Committee of European Securities Regulators (CESR).**

The European Banking Authority, EBA was established by Regulation (EC) No. 1093/2010 of the European Parliament and of the Council of 24 November 2010.

The EBA is officially functioning from 1 January 2011, with headquarters in London and has taken over all existing and ongoing tasks and responsibilities from the previous Committee of European Banking Supervisors (CEBS).

The EBA acts as a hub and communication network of EU and national bodies safeguarding such public values as the stability of the financial system, the transparency of markets and financial products and the protection of depositors and investors.

The EBA has some quite broad competences, including preventing regulatory arbitrary action, guaranteeing a level playing field, strengthening international supervisory coordination, promoting supervisory convergence and providing advice to the EU institutions in the areas of banking, payments and e-money regulation as well as on issues related to corporate governance, auditing and financial reporting.

For example, it is expected that the EBA would conduct another round of stress tests for the banks somewhere in February. The Authority will generally determine the way the EU members will adopt international regulatory standards (e.g. that of the Basel Committee) on capital and liquidity (3).

European Securities and Markets Authority

ESMA, with the headquarters in Paris, is an independent EU Authority that contributes to safeguarding the stability of the European Union’s financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

Most important, as well as difficult are, of course, the tasks to harmonise European regulations on shares, bonds and other financial instruments, including the new directive on hedge funds and private equity. The ESMA would oversight credit rating agencies, as well as the over-the-counter (OTC) derivatives market.

The inherent problem is that the process of OTC derivatives’ **clearing** is deemed to be regulated by the European Market Infrastructure Regulation (Emir) proposal (made in September 2010), while the OTC trading issues — by a separate revised Market in Financial Instruments Directive, so-called Mifid (4).

In particular, ESMA would foster supervisory convergence among securities regulators, as well as across financial sectors by working closely with the other European Supervisory Authorities competent in the field of banking — EBA, and insurance and occupational pensions — EIOPA (5).

European Insurance and Occupational Pensions Authority, EIOPA

The European Insurance and Occupational Pensions Authority, EIOPA is the third in reform-pack European Supervisory Authorities functioning from 1 January 2011; EIOPA is based in Frankfurt am Main, Germany.

EIOPA is an important part of the new European system of financial supervision with a task of devising new set of rules for the European insurance industry, in particular, the so-called Solvency II rules. The latter were heavily criticized by the insurance industry.

It is an independent advisory body to the European Parliament, the Council of the European Union and the European Commission.

Some other EIOPA's core responsibilities are to support the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and other beneficiaries. The task is rather complicated as the insurance sector needs more sophisticated modelling and management techniques than are currently in use (6).

Conclusion

The three authorities are created from various existing European "regulatory committees", which were made up of experts and regulators from the EU member states. In this regard, the previous committees were a kind of "cooperative arrangements".

The new authorities will have more exclusive powers with the apparent competence to override the national institutions, in particular in emergency situations. Besides, they are going to be more powerful both in resources and staff. All three would have a staff of about 150 and a budget of about € 40 mln. The national financial services are of much bigger size, e.g. the UK's Financial Services Authority employs about 3,000 people.

Due to the complexity of the task, some new authorities' heads will be chosen in early spring, and consultations are going on presently. The apparent thing is evident: the placement of three authorities in three main European business quarters – London, Paris and Frankfurt – shows a delicate balance in an important task of new European financial governance.

References:

1. Additional information on the Commission's website: http://ec.europa.eu/internal_market/finances/committees/index_en.htm#package

2. Atkins R. Authority aims to give early warnings to avert cries // Financial Times, 5 January 2011. – P. 2.

3. See additional information on EBA on: http://www.eba.europa.eu/Home.aspx

4. Grant J. Buyside seeks clearer view of OTC trading reconstruction // Financial Times, 10 January 2011, FTfm Section. – P. 15–16.

5. Additional information on ESMA, on: Regulation establishing ESMA; ESMA work plan and budget and ESMA's website: http://www.esma.europa.eu

6. See the EIOPA's website: https://eiopa.europa.eu/home/index.html

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