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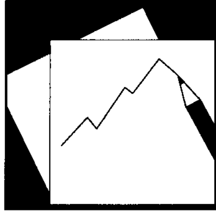

IMF Working Paper

A European Mandate for Financial Sector Supervisors in the EU

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A European Mandate for Financial Sector Supervisors in the EU

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Abstract

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The EU is deliberating the introduction of an explicit "European mandate" for financial sector supervisors to supplement national mandates. Suggestions are made on (i) the formulation of a European mandate; (ii) the policy areas to which it should apply; (iii) which institutions should be given a European mandate; (iv) the legal basis for the mandate; (v) how to implement the mandate in practice; and (vi) how to achieve accountability for fulfilling a European mandate. Decisions on these issues are needed if the introduction of a European mandate is to have a substantive positive effect.

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I. INTRODUCTION

An elaborate regulatory and supervisory structure—known as the Lamfalussy process—supports the integration of the financial sector across the EU and the maintenance of soundness in a system of ever more elaborate cross-border linkages. That structure has prudential elements, aimed at ensuring that the system remains sound even as it evolves and becomes more integrated. The structure also has elements to promote competition and transparency, so that integration can yield its full benefits in terms of allocative and cost efficiency, and incentives for innovation.

The current structure is based largely on the coordination of national policies and institutions. Most areas of prudential regulation and supervision remain primarily national responsibilities. An EU-wide regulatory framework exists, but it largely reflects a compromise among national authorities. Accordingly, it grants national authorities considerable freedom in setting specific regulations and in implementing EU Directives. Furthermore, national supervisors implement the framework and conduct on-going supervision in order to achieve a variety of objectives set out in national legislation that serve national interests. To this end they are answerable to national parliaments.

Such fragmentation may lead to poor and slow policy-making. The scope for policies that neglect spill-overs or even a "beggar-thy-neighbor" strategy may be greatest when dealing with failing institutions because authorities in each country have a fiduciary duty (and a political imperative) to minimize costs to their own country, and this may come at the expense of others. But even in less acute situations there may be a failure to internalize externalities, or a tendency to accept compromises and delays that are not in the long-term collective interest. This is unnecessarily costly and risky both for European citizens and their financial institutions.

The very success of efforts to create a common market in financial services makes the need for a matching system of oversight increasingly acute. A nationally-based system risks becoming both ineffectual and very unwieldy. Strengthening cross-border supervisory mechanisms will require more joint decision making and/or more delegation. A European mandate for supervisors could help both elements, and indeed is necessary (but far from sufficient) for a fully integrated system.

The recent global financial crisis has brought home the importance of better cross-border coordination of financial sector policies. Strains have been transmitted rapidly from country to country as the strength and complexity of interlinkages became ever more apparent. Markets and authorities had to grapple with the failure of major financial institutions with important operations in several countries. There have been efforts to coordinate the policy response (for example, by central banks in the provision of liquidity), but also episodes when

countries were in effect competing through their policies.[2] Furthermore, one of the lessons of the crisis is that supervisors and other authorities responsible for financial sector stability need to take a more holistic, systemic approach, not only domestically but also internationally.

There is therefore growing and widespread recognition of the value of assigning a "European mandate" to financial sector regulators and supervisors, and to associated European structures (Appendix I). There has been progress in the recent past on a number of related elements: the acceptance of the concept of a European mandate or at least the desirability of supervisors taking into account the "European dimension" of their actions; formal recognition that financial stability is a common concern; a commitment to share the fiscal costs of a financial crisis; greater readiness to delegate powers to supervisory colleges, etc.; and the development of mechanisms to ensure that Level 3 Lamfalussy committees operate with more of a joint European orientation. More specifically, the May 2008 EU Economic and Financial Council (ECOFIN) meeting endorsed a recommendation for the possible introduction of EU mandates in national supervisors' mission statements.

This paper presents some suggestions on how to give national supervisory authorities and other connected agencies and European structures an effective "European mandate." Many of the suggestions are based on a normative approach, in the sense that they assume that political and legal hindrances are overcome. It is recognized that, in current circumstances, it will be difficult to institute a European mandate in a way that deeply affects the financial sector policy in practice. Nonetheless, the suggestions may show the direction in movement that is needed.

The next section reviews the current structure of supervisory cooperation and the allocation of responsibilities, identifies inconsistencies and possible sources of inefficiencies associated with the current lack of a European mandate, and assesses what a European mandate might achieve. The following section discusses how the European mandate might be formulated; and how it might be balanced against other mandates; measures to implement or embody a European mandate; and what supporting arrangements might be needed, notably with regard to accountability.

II. A System of National Supervisors

Current arrangements

Most financial sector regulatory and supervisory activities in Europe are currently organized on a national basis. In each country, one or more authorities have the responsibility for issuing regulations, granting and taking away licenses, conducting on-going supervision, and taking enforcement action. These supervisory authorities are empowered by national

[2] Hardy and Nieto (2008) discuss competition in deposit insurance.

parliaments, are subject to national accountability mechanisms, and obtain financing from national sources. For banks, each country's authority (or set of authorities) is responsible for the consolidated supervision of institutions and groups domiciled in that country, for which it is the home supervisor. It is also responsible, as host supervisor, for oversight on a stand-alone basis of subsidiaries of institutions from other member states operating in its jurisdiction.[3] Several authorities have commitments to cooperate with counterparts abroad expressed in national laws or their mission statements.

How supervisory and related powers are organized is quite diverse (Table 1 and Figures 1 and 2). EU member countries differ in the roles assigned to a separate supervisory authority, the central bank, the Ministry of Finance, a separate deposit insurance scheme, and private organizations.[4] The objectives and mandates of the supervisory authorities vary likewise. The diverse objectives include (i) financial sector stability; (ii) the protection of depositors; (iii) the protection of investors and creditors; and (iv) fostering the financial sector. Responsibility over prudential, market-conduct, competition, and consumer protection policies are unified to a greater or lesser degree.

On top of these national institutions lies a complex structure designed to facilitate cooperation. Important elements include:[5]

- A large number of bilateral and some multilateral Memorandums of Understanding (MOUs). MOUs typically commit the signatories to regular exchange of information and timely consultation on enforcement action. Several countries (e.g., in Scandinavia and the Benelux) have entered into special MOUs to deal with individual banks of regional systemic importance. There are also some EU-wide or EMU-wide MOUs on such matters as the provision of emergency liquidity and financial crisis management, the most recent of which dates from April 2008 (Appendix I).

[3] Supervision of the insurance sector is more nationally oriented, based on the so-called "solo-plus" principle.

[4] European deposit guarantee schemes do not generally have supervisory role. In some countries, associations of banks de facto supervise themselves to some extent. Self-regulation elements are more common in the nonbank financial sector.

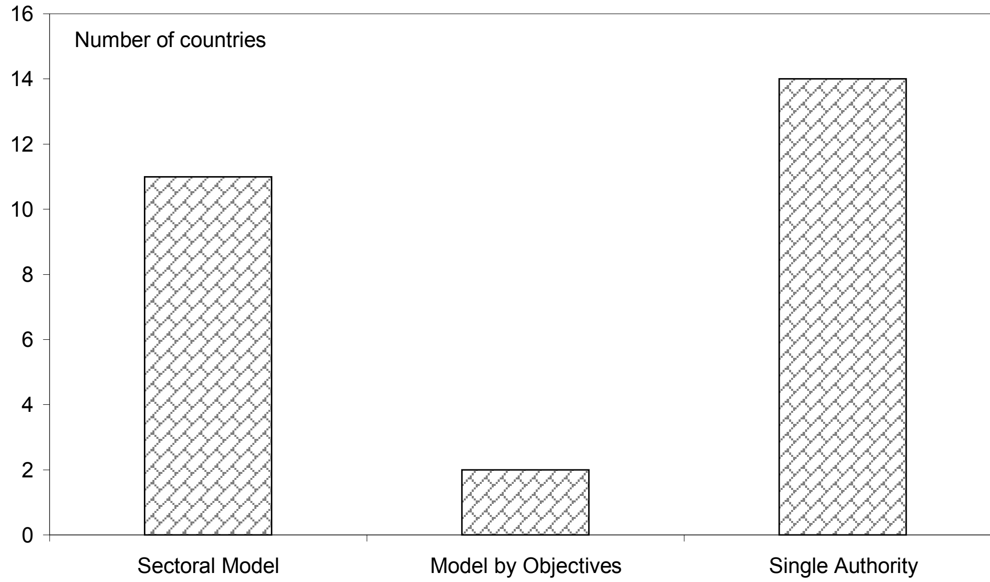
[5] More information is available in Decressin, Faruqee and Fonteyne (2007), Kremers, Schoenmaker and Wierts (2003), and Nieto and Peñalosa (2004).

Table 1. EU Area: Supervisory Structures

Country	Supervisory Structure			Central bank directly involved in bank supervision	Main tasks/areas of supervision of the financial authority							
	Sectoral model	Model by objectives	Single authority		Banking supervision	Pension fund supervision	Insurance supervision	Securities supervision	Stability	Conduct of business	Consumer & depositor protection	Market compet-ition
Austria			X	X	X	X	X	X	X	X	X	
Belgium			X		X	X	X	X		X	X	X
Bulgaria	X			X	X	X	X	X	X		X	
Cyprus	X			X	X		X	X	X		X	
Czech Republic			X	X	X	X	X	X	X	X		X
Denmark			X		X	X	X	X	X	X	X	X
Estonia			X		X	X	X	X	X	X	X	
Finland	X				X	X		X	X	X	X	
France	X				X	X		X	X		X	
Germany			X	X	X	X	X	X	X	X	X	
Greece	X			X	X	X		X	X	X		
Hungary			X		X	X	X	X	X	X	X	X
Ireland			X		X	X		X	X		X	X
Italy	X			X	X	X	X	X	X	X	X	X
Latvia			X		X	X	X	X	X		X	
Lithuania	X			X	X	X		X	X		X	X
Luxembourg	X				X	X	X	X	X		X	
Malta			X		X	X		X		X	X	X
Netherlands		X		X	X	X	X	X	X	X	X	X
Poland			X		X	X	X	X	X			
Portugal	X	X		X	X	X	X	X	X		X	
Romania	X			X	X	X	X	X	X			
Slovakia			X	X	X	X	X	X	X	X	X	X
Slovenia	X			X	X	X	X	X	X		X	
Spain	X			X	X	X	X	X	X		X	
Sweden			X		X	X	X	X	X		X	
United Kingdom			X		X	X		X	X		X	

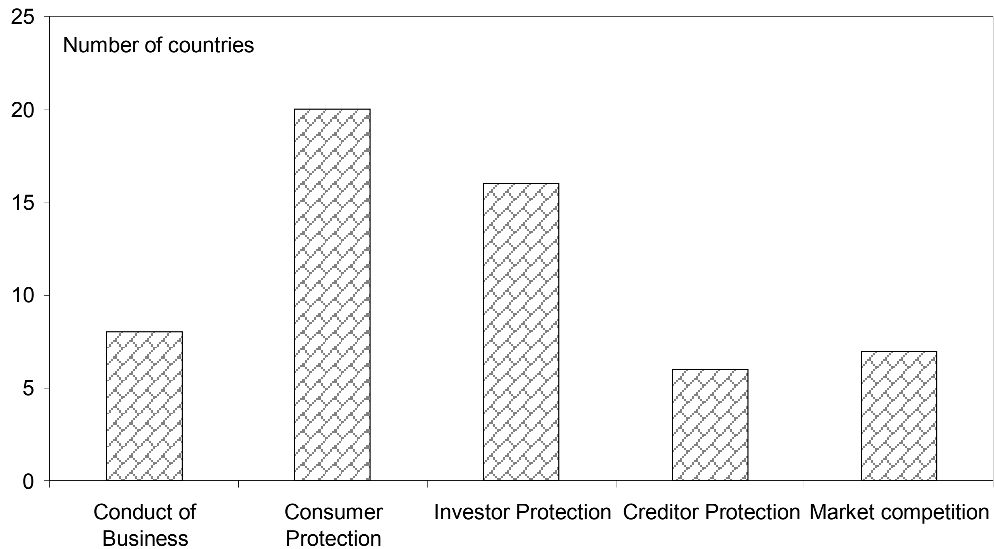
Source: National authorities, and ECB (2006).

Figure 1. EU Area: National Supervisory Models



Sources: ECB (2006); and national authorities.

Figure 2. EU Area: Main Additional Tasks of National Supervisory Authorities



Sources: ECB (2006); and national authorities.

- "Colleges" of supervisors follow the activities of cross-border insurance groups and some banks. Currently, colleges are in operation for the major cross-border banks in the Benelux and Nordic regions, and a number of "pilot case" colleges for other major banks have been established. The May 2008 ECOFIN conclusions recommended the extension of supervisory colleges to all European banking groups with cross-border activities. The June 2008 MOU on crisis management envisages the establishment of Cross-Border Stability Groups, which can be considered to be colleges expanded to include other concerned institutions such as Ministries of Finance, bank resolution agencies, and central banks without supervisory responsibilities.

- The Lamfalussy process.

  - "Level 1" of the Lamfalussy process consists of the framework legislation setting out the core principles and defining implementing powers. The technical details are formally adopted by the Commission as implementing measures at "Level 2" after a vote of the competent regulatory Committee (the European Securities Committee, the European Banking Committee and the European Insurance and Occupational Pensions Committee).

  - Three committees of supervisors (so-called "Level 3" committees) have been established for the banking, insurance, and securities sectors, respectively, to promote financial sector integration in Europe. These committees meet regularly and make proposals for the coordination of financial sector regulation and supervision. Level 3 committees, made up of representatives of national supervisors, provide technical advise to the Commission and Level 2 committees on draft implementing measures and proposals for framework legislation, and work to ensure more consistent and day-to-day implementation of EU legislation by issuing guidelines and reviewing/ converging national regulatory and supervisory practices. Qualified majority voting is now used extensively in deciding the technical advice to be provided to the Commission. The Level 3 committees are taking on new tasks, such as the development of guidelines for the functioning of supervisory colleges and the assessment of key financial sector vulnerabilities, which are reported to the so-called Financial Stability Table of the Economic and Financial Committee (EFC).[6] "Level 4" is where the EU Commission enforces the timely and correct transposition of EU legislation into national law.

- EU institutions. The EU institutions are not directly involved in financial sector supervision, but they have important powers in three relevant areas.

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[6] The EFC comprises within its normal composition representatives of EU finance ministries, national central banks, the ECB and the Commission. The FST consists of the EFC extended to include the Chairs of the EU supervisory committees and the ECB's Banking Supervision Committee.

  - First, agreed EU regulations are directly applicable in all Member States; EU directives are binding as to results to be achieved, leaving to the Member States the choice of form and methods. Directives that have recently come into force or that are scheduled to come into force in the near future include the Capital Requirements Directive (CRD) for banks (fully implemented from January 2008 onward), the Market in Financial Instruments Directive (MiFID) for the securities sector (November 2007), and the Solvency II directive for the insurance sector (targeted for 2012).

  - Second, the Council of the European Union discusses financial sector policy and can adopt conclusions setting the agenda for the coming period, of which the recent conclusions on developing "burden sharing" and a "European mandate" are examples.

  - Third, the EU Commission has autonomous powers in areas relating to the completion of the common market, competition and trade negotiations, including trade in services. The Commission also has enforcement powers in its areas of competency. Thus, actions such as mergers between financial institutions, injections of state capital, and the cross-border provision of financial services (also to and from countries outside the EU) can be reviewed by the Commission and possibly affected by its decisions.

- The European System of Central Banks (ESCB) and European Central Bank (ECB). In the euro zone, the ECB does not have direct prudential supervisory responsibilities, and many central banks that are members of the ESCB have little or few on-going prudential supervisory responsibilities. However, as provider of lender of last resort liquidity and with their responsibilities for monetary policy and payment system oversight, the central banks cannot be divorced from stability concerns.[7] The current arrangement is that each national central bank is responsible for emergency liquidity provision to financial institutions domiciled in its jurisdiction (and for taking on any associated risk), but the ESCB and ECB need to be kept informed on a timely basis so that offsetting monetary action can be taken if needed. Furthermore, as has occurred recently, the ECB may decide to inject liquidity on an ad hoc basis to ease strains in the system-wide money market. The ESCB statutes anticipate some role in prudential supervision of credit institutions, which mandate it carries out with the assistance of the Banking Supervision Committee.[8]

- Multinational institutions and standard setters. The European financial sector authorities are major actors in a number of multilateral organizations and forums, and

[7] See European Central Bank (2008).

[8] Art. 3.33 of the ESCB/ECB Statute states that "In accordance with Article 105(5) of this Treaty [establishing the European Community], the Eurosystem should 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."

they are affected by the latter's decisions. For example, EU legislation on financial sector prudential matters are designed to be consistent with (and in many instances exceed) the principles promulgated by the various standards setting bodies, such as the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS), and International Organization of Securities Commissions (IOSCO). The Bank for International Settlements, the Financial Stability Forum, and the IMF in its financial sector surveillance each has an influence.

Arrangements are continuing to evolve, a process that has accelerated under the pressures generated by the current global financial crisis. Notably, In November 2008 a "High Level Expert Group on EU financial supervision" was established in November 2008 to advise the Commission on strengthening European supervisory arrangements.

Rationale for current arrangements, and the costs

This structure represents the outcome of a long process of evolution, yet can be interpreted as broadly in accord with certain EU principles. Subsidiarity is meant to be respected, in that responsibilities are to be assigned to the lowest level that can effectively meet them. In particular, centralization is limited and member states are (de facto and de jure) allowed considerable freedom in areas not explicitly addressed in EU legislation. Thus, a country can adapt regulations and supervision to the needs of its financial system and economy more widely, and countries can experiment with a variety of approaches. At the same time, many of the provisions—such as the mutual recognition of standards and licenses—are designed to ensure that there can be trade in financial services across borders. Furthermore, EU directives and regulations are designed to ensure that there is no "race to the bottom," that is, that there are minimum standards such that regulators cannot compete without restriction to favor their national industries.[9]

Nonetheless, there are concerns that current structures are being overtaken by the pace of financial industry innovation and integration.[10] First, reliance on consensus and the operation of large committees may result in sclerosis, with slow decision-making, while financial innovation keeps accelerating. Second, committee decisions may be sub-optimal.[11] For

[9] A "race to the bottom" occurs when regulators compete to minimize the regulatory burden in order to attract firms; Dell'Ariccia and Marquez (2001) model regulatory competition in the financial sector.

[10] The issues are extensively discussed in the literature on the supervisory structure in the EU that has already been cited, and for example in Garcia and Nieto (2007), Holthausen and Rønde (2005), and Nieto and Schinasi (2007).

[11] Academic literature suggests that the outcome of decision making by committee may be far from maximizing aggregate welfare, and may depend on such factors as the voting rules, sequence of items on the agenda, timing of communication, and the size of the committee (Gerling, Grüner, Kiel and Schulte, 2005, provide an overview).

(continued…)

example, consensus might sometimes be achieved by recognizing all current national practices, thus hindering integration and adding to the regulatory burden.[12] Third, the committees may be biased towards outcomes that favor established interests (including those of national supervisory institutions themselves) that are effective in lobbying at a national level, rather than maximize welfare for the EU as a whole.[13] This favoritism may be motivated by a desire to promote national financial institutions (for example, by claiming a prudential justification for a measure that limits entry, i.e., as a nontariff barrier) or to shift the burden of regulation and enforcement to others. Thus, there may be a "race to the bottom" in some areas, but "Gold Plating" in others.[14] Fourth, due to the complexity of the regulations and other arrangements, it is easy for national authorities to implement them in a way that favors national interests, for example, by being slow to convey all information to other supervisors. There have been incidents where prudential instruments have been used to protect private domestic institutions. Fifth, the costs of decentralization are mounting as financial institutions and markets become more integrated; national authorities individually are no longer able to exercise effective supervision of cross-border groups.[15]

Financial institutions will react to this situation in ways that may compound the costs involved. On the one hand, they may hold back from entering other EU markets in order to avoid the extra regulatory burden. On the other, they may seek out means of regulatory arbitrage. In any case, they have a strong incentive to engage in lobbying and other efforts to "capture" regulators.

There are, however, mitigating circumstances. European governments and financial sector regulators are committed to European institutions and are aware that they will have to operate in cooperation with each other in a wide range of fields for the indefinite future. This is a repeated game with effectively no reasonable possibility of exit, so cooperative solutions and the building of good reputations are rational approaches.[16] Each country knows that, over any

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[12] For example, some commentators have suggested discussions on reporting definitions, formats and requirements have been characterized by agreements to disagree rather than streamlining or harmonization.

[13] Considerable lobbying goes on at a European level, but here European-wide interest groups predominate. There are grounds for thinking that decisions made under inter-governmental structures are more prone to distortion by lobbying than are decisions made by a union-wide authority (Ruta, 2003).

[14] "Gold Plating" involves adding extra provisions to those contained in harmonizing Directives, which could be motivated by a desire to shift any problems to other jurisdictions, or by favoritism toward domestic firms that are more adapted to the Gold Plating provisions.

[15] The issues are relevant more widely as global financial markets integrate (Evanoff and Kaufman, 2007).

[16] Trondal (2004) provides an interesting analysis of the mixture of intergovernmental, functional, and supranational forces at work in EU committees.

one instance, it cannot seek its own advantage without constraints, because its European partners have a wide range of opportunities to retaliate (including in the nonfinancial area). Immediate national interest may override these considerations in extreme situations—such as a financial crisis—but the considerations are powerful in normal times.

Furthermore, conflicts of interest are centered around fiscal concerns—e.g., the cost of bank rescues and the benefit of attracting financial sector firms—rather than around stability per se. Yet, each country has a strong interest in the soundness of the institutions in the other countries, as recent market turbulence has demonstrated once again. Moreover, as the markets and institutions integrate, the definition of national interest may become more complex, particularly with respect to financial sector stability. For example, if many of the shares of a bank licensed in country A are held by residents of country B, or if a subsidiary of a country B bank is a major player and employer in country A, then it is not clear which regulator will give most weight to the interests of that bank. Again the recent financial crisis has demonstrated that sectoral and business interests can cut across national borders. Finally, it should be recognized that the European economy is large, diverse and complex, and effective supervisory arrangements will to some extent have to reflect that complexity.

How might a European mandate help?

If supervisors and other relevant agencies were to be given an effective European mandate that significantly influences their behavior, advantages could be expected on three areas:

First, a European mandate would give EU convergence and cooperation operational weight at the national level. There would be less willingness to erect surreptitious nontariff barriers or to shift burdens onto others, and perhaps more readiness to give up traditional national practices in favor of common practices, thus lowering the supervisory burden on financial institutions.

Second, a European dimension in the mandates of national supervisors could enhance the functioning of the Level 3 committees at the EU level and supervisory colleges at the level of individual institutions. In particular, a European mandate for national financial sector authorities could help produce joint decisions that are more timely and more conducive to promoting the common EU good. Consensus would be easier to reach if participants in the various committees and other forums were aiming to achieve what is best for the EU as a whole, rather than negotiating among potentially conflicting national interests. The decisions that are made would better reflect aggregate welfare, rather than that of those countries or interest groups who are most immediately affected and are most effective in lobbying national authorities. These considerations are gaining in importance because decisions coming out of the Lamfalussy process are to be given more weight, with Member States subject to a "comply or explain" mechanism.

Third, a European mandate will facilitate the further development of a more efficient and effective European stability framework, which will be necessitated by the on-going

integration of European financial markets and commercial institutions (and EU expansion). On the one hand, the spill-overs that justify coordinated or centralized policies will only gain in importance.[17] On the other hand, supervision based on national supervisors risks becoming ever more cumbersome, costly, and potentially risky. Large financial groups already have bank and nonbank operations in many member states, and in response authorities will have to establish supervisory colleges or stability groups with tens of member agencies. Large and diverse committees are not conducive to the speedy decision making that financial sector policy often requires.[18] Hence, more elements of delegation and tiering of responsibilities may have to be introduced (for example, an institution's supervisory colleges might include a core of supervisors from countries where it is very active, and a periphery of supervisors from countries where it is less important). National authorities can and will agree to such delegation only if they are sure that their interests are being given full weight, that is, if the authority or authorities to whom responsibilities are delegated are acting in the collective interest. Thus, a European mandate could contribute to streamlining supervision and reducing regulatory burdens.

These benefits might be obtained in the operation of Level 3 committees, in national supervisory authorities' operations in normal times—in the process of formulating regulations, licensing institutions, and conducting supervision—and in their operations in more extreme situations, such as a financial crisis, when also other authorities will be involved. Some measures could help implement a European mandate in Level 3 committees and in normal times when national authorities interact in a "repeated game" for relatively low stakes; they might loose force under severe stress, but they will nonetheless be of value.

However, there is a clear danger that the notion of a "European mandate" will become vacuous. It would be easy for country authorities to declare their commitment to a noble goal, but carry on as before, and be ready to defend interests at every turn, while providing a spurious explanation of how selflessly they are acting. Everyone is in principle in favor of cooperating and sharing information, but implementation is costly even under benign circumstances, and doubly so when important financial interests are at stake. Hence, this may end up an obligation more honored in the breach than in the observation.

Introducing a European mandates for supervisors (and others) may even entail significant costs if not very carefully designed:

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[17] Oates (1972) formalized the intuition that centralization is more desirable, the greater are spill-overs, a result that seems to be robust to the incorporation of more complex political arrangements and policy choices (Besley and Coate, 2000).

[18] Some of the possible coordination problems were manifest in the various crisis simulation exercises that European supervisors and other agencies have conducted. While arrangements for coordination of monetary policies and operations seem to have functioned well in exercises (and during the current crisis), other elements of financial policy were much more difficult to coordinate.

- Current arrangements are already highly complex, which may provoke skepticism as to their effectiveness. Adding another layer of provisions and obligations in the name of "European mandates" may reduce transparency and accountability, which may widen the scope for machinations by interest groups (including supervisory authorities themselves).

- The direct cost of fulfilling a European mandate—in terms of staff time, travel to coordination meetings, preparations of publications, etc.—may be significant, and distract from the core business of supervising commercial institutions.

- The complexity of dealing with crisis situations may be increased if financial supervisory authorities have European mandates, while other authorities that are necessarily involved—notable Ministries of Finance—are not.

- An excessive focus on European convergence and mutual responsibilities may reduce the scope for using local information and adapting to local conditions, and stifle innovation and healthy competition among regulators.

An alternative to introducing a European mandate for national supervisors would be delegation to a European supervisory agency, which, however, would introduce its own complexities, and does not seem likely in the near term. and but establishing such an agency would take years even if there were political consensus on its desirability. The European mandate (and greater reliance on lead supervisors) could be regarded as half-way measures between reliance on narrowly national authorities and institution of a European supervisory institution. Such a compromise risks augmenting the bureaucratic burden. However, superior to a European supervisor along two lines: First, supervisors need proximity to gather information on the markets in which the financial institutions operate, so national institutions may have informational advantages over European ones. Moreover, in order to be effective in crisis situations, supervisory power needs to be backed by financial powers, notably a central bank's ability to act as a lender of last resort and a government's ability to levy taxes. As the EU lacks such powers, the effectiveness of a European supervisor would be limited, especially in the crisis situations where cross-border effects are strongest.

III. Formulation and Implementation of a European Mandate

A number of questions need to be answered if financial sector regulators and supervisors are to be charged with fulfilling a European mandate.

How might a European mandate be formulated?

The European mandate should center on financial sector stability. The European mandate might be extended to cover many areas besides stability, such as consumer and investor protection; the promotion of competition and innovation; or combating financial sector crime and money laundering. However, the inclusion of more objectives complicates any definition and increases the scope for conflicts among objectives. Furthermore, explicit mention of obligations towards specific groups raises the issue of institutional liability in case something

goes wrong due to negligence, fraud or bad luck; the legal regimes governing institutional liability for supervisors differ significantly across Europe, and convergence in this area may be a distraction. In any case, the aim should not be to protect particular institutions or other parties who take on commercial risk. Moreover, countries and regional institutions may have other commitments in these areas (for example, under EU competition policy and UN resolutions). Hence, a more focused approach seems appropriate at the initial stages.

Stability, though, is a fairly broad concept. For example, stability involves no crises, but, in addition, a financial system cannot be stable in the long term unless it is adequately profitable. Furthermore, a certain balance must be maintained between the desire for financial system stability, and the direct and indirect costs of regulation. Determining the optimal degree of regulation and supervision must involve recognition of the trade-offs. Hence, the need for efficiency must be recognized.[19]

Even within prudential policies, there are a number of elements: licensing, regulation, on- and off-site supervision policies and practice, enforcement, and intervention and resolution/closure. The last area is most prone to generating sharp conflicts between countries, but conflicts in such areas as entry (de novo or through takeovers) have also been seen.[20] Furthermore, intervention may require quick decision-making and the maintenance of strict confidentiality, which will limit time and incentives for consultation and careful evaluation of all ramifications. At least to start with, it would be prudent to concentrate on the areas where conflict is likely to be less acute.

Arrangements between Australia and New Zealand may serve as a model for some aspects of the formulation. In light of the very close integration of their financial systems, these countries recognized an interest in an explicit and mutual commitment to take into account cross-border spillovers (Box 1). The arrangement seems to work despite the asymmetries between the countries. The European context, with many more countries, is much more complex. However, cooperation should be easier because of the greater symmetry across

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[19] The term "efficiency" will be used here as a shorthand for concerns such as reducing costs of doing business for financial sector firms and their clients, promoting the development of the sector and allowing innovation, and the operation of fair markets that aggregate information effectively. Several European supervisors have both a stability objective and explicit objectives to promote efficient markets, improve business capability and effectiveness, or ensure the financial system's profitability.

[20] Following some celebrated cases of national favoritism, a directive has been adopted to deal with these "entry" issues, and clarify the powers recognized to supervisory authorities in the context of, for example, a proposed take-over.

Box 1. Mutual Responsibilities of Supervisors in Australia and New Zealand

Australia and New Zealand amended financial sector legislation in 2006 with the express aim of giving national supervisors a mandate to take into account financial stability concerns in the other country. In particular, each supervisor is meant to support the other and, whenever reasonably possible, to avoid actions that would adversely affect the financial system stability in the other country, and to consult if possible before taking actions that could have a major cross-border impact. Thus, supervisors are required to make an effort to consult each other and take each other's interest into account, but it is recognized that this may not always be possible when time is of the essence. Specific mention is made of actions that interfere with the provision of outsourced services. Furthermore, a bank administrator or statutory manager is to inform the supervisor if they believe that their action may have a detrimental effect on financial stability in the other country.

The countries agreed to this intensified form of cross-border cooperation in recognition of the fact that the New Zealand banking system is almost entirely owned by large Australian banks (as is the rest of the financial system). Furthermore, institutions in New Zealand have outsourced many functions to their parent banks in Australia. The arrangement seems to work despite the asymmetry between the countries, which *a priori* might be expected to lead to conflicts of interest. In this regards, it is worth noting that:

- As part of this reform, the Australian Prudential Regulatory Authority had to be given an explicit mandate to promote "financial system stability," which previously had been the sole preserve of the Reserve Bank of Australia. The Reserve Bank of New Zealand has all supervisory functions.
- Australia grants depositors preferential status in bank resolution. New Zealand does not offer deposit insurance or any special protection for depositors.
- There does not appear to be a mechanism dedicated to achieving accountability for these mutual responsibilities.

countries (and especially the biggest half-dozen financial systems) and the presence of countries that are both home and host supervisors.[21]

One approach would be to define a broad European mandate, and then add several specific "dos and don'ts." This approach would help ensure that the European mandate is flexible but sufficiently well-defined to be effective, and would facilitate accountability. The more specific responsibilities would be preceded by a clause allowing unilateral actions when authorities are faced with force majeur.

[21] Oates (*op.cit.*) makes the case that cooperation is easier, the more homogenous are the members of the policy union, but this result may be weakened when decisions are made by representatives elected at a union or local level (Besley and Coate, *op. cit.*).

The broad European mandate could be formulated along the following lines:

> *The [authority] will, in cooperation with our European partners, seek to maintain and promote the financial soundness, efficiency, and integration of the European financial system as well as those of all EU countries involved, in the planning and execution of its financial sector policies.*

There could be an additional explication that financial sector stability is a common good shared among European partners, and of value not only to the financial sector but to the economy as a whole. In this formulation, efficiency is given explicit recognition alongside stability. Thus, for example, a European mandate would imply a commitment to strive for uniformity of treatment and interpretation of regulation across the EU, which is important for financial sector cost efficiency and competition.

The specific "dos and don'ts" might include some or all of the following:

> *Insofar as reasonably practical and without endangering the financial soundness and efficiency of the European financial system, the [authority] will*
>
> *(i) consult and coordinate with European partner authorities before taking action that would significantly affect financial systems in other Member States;*
>
> *(ii) assist, including by providing relevant information, European partner authorities in their efforts to maintain and promote financial sector soundness and efficiency;*
>
> *(iii) avoid taking actions that hinder the integration of European financial markets;*
>
> *(iv) avoid taking actions that are likely to have the effect of unilaterally shifting to other Member States the costs associated with financial sector regulation and supervision, or those associated with other financial sector policies; and*
>
> *(v) minimize the potential harmful economic impacts at the lowest EU-wide cost when managing and resolving financial crises.*

Which authorities should be covered?

Even on a country level, several institutions are involved in setting and implementing financial sector policies. All of them might in principle be given a European mandate, although there may be constitutional difficulties in some cases. A European mandate for Ministries of Finance might conflict with their explicit fiduciary duties and answerability to

national parliaments.[22] Central banks in their lenders of last resort and monetary policy functions are covered by other provisions, such as the ESCB MOUs on emergency liquidity provision for relevant member states.

It is suggested, therefore, that at a minimum the mandate be given to those institutions most directly involved in on-going financial sector regulation and supervision, namely, the financial supervisory authorities (where they exist) and relevant central banks that have this responsibility. One practical criterion would be to require a European mandate for all members of the Level 3 Lamfalussy committees, which includes central banks. Indeed, a European mandate for central banks is important even when they do not have prudential supervisory responsibilities because they have a central role in maintaining the smooth functioning of money markets and payment systems, where cross-border spill-overs are large.[23]

Furthermore, the Level 3 Lamfalussy committees themselves and their participants qua members could be given a European mandate. The aim would be to foster decision-making that promotes overall EU welfare, not that of a winning coalition of member states.

Financial institution conservators, administrators or receivers should be given a European mandate. Since cross-border spillovers may be especially important in dealing with problem institutions, such a European mandate may be highly valuable. Experience during the recent global financial turmoil and from the various crisis simulation exercises (so-called "war games") suggest that cooperation can be satisfactory at most times, when predominantly supervisors and central banks are involved, but breaks down when there is a real threat of conservatorship or resolution; national conservators or receivers typically have narrow mandates which requires them to "ring fence" assets and try to recoup assets from other jurisdictions, thus precluding a cooperative solution. The Australian-New Zealand provisions could serve as a model. Such a provision could be introduced as part of a wider reform and convergence of financial institution insolvency procedures in Europe.[24] However, assigning to them a European mandate may not be fully realizable until the prickly issue of burden sharing, which has been resolved in broad principle, is resolved in practice.

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[22] Member states are individually responsible for maintaining financial stability under the European Treaties.

[23] The Eurosystem and in particular the ECB already have a strong European dimension in the definition and execution of their responsibilities, as enshrined in the EU treaty.

[24] Under directive 2001/24/EC, where a credit institution with branches in other Member States fails, the winding up process is subject to a single bankruptcy proceeding initiated in the Member State where the credit institution has its registered office and governed by the bankruptcy law of that state. The Commission has launched in 2007 a public consultation on this directive to examine whether the Directive fulfils its objectives, whether it could be extended to cross-border banking groups, and how obstacles related to asset transferability within such groups can be addressed.

It may also be useful and feasible to give a European mandate to deposit insurance schemes. A European mandate for deposit insurance schemes could be valuable if it helped ensure uniform treatment of depositors in case of resolution. Deposit insurance schemes are already obliged to provide the same coverage to depositors at a bank's branches anywhere in the EU. Nonetheless, the practical procedures of making cross-border payouts in case of need may deserve special attention.[25] The reform of European deposit insurance schemes is on the policy agenda following the recent global financial turmoil, which will provide occasion to consider this issue.[26] However, deposit insurance schemes are highly diverse across the EU, and in some cases are private, which would complicate the introduction of European mandates.

How can a European mandate be embodied and implemented?

Legislation

A very strong legal basis for a European mandate is especially important in relation to dealing with problem institutions and, *a fortiori*, crisis situations. These are the circumstances when national authorities are most likely to focus on the letter of the law and disregard longer-term consequences of non-cooperation: first, crises are inherently unpredictable and dangerous for the reputation of decision-makers. Faced with these risks, decision-makers may be more apt to revert to following the strict letter of the law. Second, major crises are rare and the stakes are high, so the temptation to act in narrow national self-interest is great and the scope for retaliation for non-cooperation is relatively limited. Hence, a European mandate may be especially valuable in these circumstances.

The strongest way to assign a European mandate to national financial sector authorities would be through legislation passed by national parliaments. Those authorities would then have unambiguous powers and responsibility to take action to achieve the European mandate. The national parliaments and their agents (such as the Ministry of Finance in many countries) could also verify that they have been fulfilling these responsibilities (see below).

However, it must be anticipated that changing a large number of national laws would be a lengthy and legally complex process. During that process, national parliaments may insist on modifying the European mandate in idiosyncratic ways, thus partly undermining its unifying intent. Furthermore, legal and constitutional systems differ across Europe, for example, with respect to the amount of discretion that can be left to government authorities and how precisely responsibilities and powers must be defined.

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[25] For example, deposits of a failed bank may need to be transferred to another institution, which will make payouts or acquire the deposits under a purchase and acquire scheme. It may be impractical to use the same recipient bank in all countries where the failed bank had branches.

[26] See Hardy and Nieto (*op. cit.*).

These possible inconsistencies could largely be avoided if the national laws were formulated so as to translate an EU Directive. Another possibility would be an EU Regulation, under which there would be less scope for national discretion; since the case for national discretion is weak in an area that seeks to address the potential for cross-border spillovers of national actions, a regulation would be prime facie preferred to a directive. However, an issue to be resolved is whether current treaties provide a basis for a directive or regulation in this area.

Supervisory practice and institutions

For supervision during normal times, a European mandate for supervisors may be effected using means that are more adaptable and more under control of the supervisors themselves. These measures may also be adopted to implement a mandate enshrined in national Level 1 legislation. The following (non-exclusive) possibilities suggest themselves:

- Inclusion of the European mandate in authorities' mission statements, as suggested by the Inter-Institutional Monitoring Group (IIMG). However, the effectiveness of such a non-binding and non-operational commitment may be questionable;

- An EU-wide MOU. However, the effectiveness of such a non-binding and non-operational commitment in periods of stress may be questionable;

- Appointment of a high-level officer in each authority with responsibility for promoting European financial sector integration and cooperation;

- Inclusion on the Board of each authority of a member with special responsibility for promoting European financial sector integration and cooperation. The Board member could come from an EU institution or another EU member country;

- A commitment that all major decisions (on regulation, licensing, perhaps enforcement action, etc.) will be preceded by a "European Impact Study" designed to assess its consistency with the European mandate. There could be a presumption that the impact studies will be published, perhaps with a lag, and possibly reviewed by other supervisors or the EU. However, there might be a need for an override provision, such that rapid enforcement action and intervention can be undertaken if circumstances warrant;

- Requiring that authorities pool some resources for common projects (such as the supervision of transnational banks), and/or that financial institutions from across the EU contribute directly to a common pool. Although the absolute amounts may not be large relative to government budgets or the potential cost of financial bail-outs, fiduciary responsibility may strengthen incentives to pursue cooperative strategies;

- Establish systems for sharing information and agreeing on procedures, such that each deposit insurance scheme can honor claims uniformly across jurisdictions. The uniform treatment would be not only in terms of coverage, but also in terms of the speed and modalities of payouts. Fulfillment of the European mandate might require

schemes to meet certain minimum standards for payout procedures and conditions, and not merely of coverage; and

- Introducing language on the European mandate into the rules and statutes establishing the Level 3 committees.[27]

How to balance mandates

A European mandate may come into conflict with other mandates to which supervisory authorities and central banks are subject. Conflict cannot be excluded even if a European mandate is embedded in national legislation. Indeed, conflicts may arise among existing national mandates (for example, for a central bank, between the commitment to monetary stability and responsibility for the smooth functioning of the financial sector), and in extreme situations notionally autonomous authorities are likely to come under strong pressure to modify their behavior; a supervisor cannot ignore macroeconomic and fiscal considerations when dealing with major financial shocks. Currently, the scope and clarity of national authorities' responsibilities is diverse, especially with respect to concerns other than financial stability, such as the "fair" functioning of financial markets and consumer and investor protection.[28]

Conflicts are likely to be most acute when financial sector policies intersect with fiscal policy, and in particular when dealing with deposit insurance and the resolution of problem institutions—a possibility of which policy-makers and the public have become painfully aware by recent events. Potential conflicts here may be unavoidable, but failures of major financial institutions are intrinsically difficult to plan for. The other main area of conflict is likely to arise from economic nationalism, as expressed for example through the promotion of "national champions." Yet, even in extreme situation, policy-makers face a continuum of possible actions, and some counterweight to short-term self-interest would be worthwhile. The establishment of a European mandate may push the game towards a more cooperative solution, and thus still be worthwhile.

A practical approach may be to accept a hierarchy of mandates. Preferably, national authorities would be responsible first for fulfilling a European mandate for financial stability, and then be responsible for the soundness and efficiency of national financial systems, subject to which they possibly could pursue other mandates (such as investor or consumer protection). The analogy would be with the responsibility of many central banks to pursue

[27] The ECOFIN already sets the agenda in broad terms, and the European Parliament will from now on monitor their work programs.

[28] Hüpkes, Quintyn, and Taylor (2005) document that supervisors often have multiple objectives with no clear ranking.

price stability, subject to which they may act to promote full employment, etc.[29] Such a hierarchy would not prevent all conflicts, but it would limit them to cases where stability objectives are at odds. Furthermore, a clear hierarchy would be keeping with the principles of the international standards for effective financial sector supervision and regulation.[30]

Even if countries choose to place the mandate to promote the soundness of respective national financial systems above the European mandate, it is essential that the latter have precedence over non-prudential objectives, such as minimizing quasi-fiscal costs or promoting the national financial industry. As argued above, conflicts between Member States in financial sector policy may be much more acute in these areas than in prudential policy per se. The European mandate needs to have priority over these objectives if it is to facilitate policies that are good for Europe as a whole.

Introducing a European mandate, especially when it is embedded in national legislation (or EU Regulations or Directives), may be an occasion to rationalize and possibly harmonize other aspects of supervisory authorities' overall mandates. A greater degree of harmonization of non-stability mandates may be useful in achieving further integration of financial markets.

How to achieve accountability?

The autonomy enjoyed by central banks and financial sector supervisors in Europe must be balanced through accountability. Strong incentives to fulfill a European mandate require a strong accountability mechanism. An accountability mechanism, which effectively

[29] The ECB has such a hierarchy of objectives: according to Article 105(1) of the Treaty establishing the European Community, "the primary objective of the 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" of the Treaty on European Union, which are a high level of employment and sustainable and non-inflationary growth. See Scheller (2006) for an exposition of the rationale for these provisions.

[30] The International Association of Insurance Supervisors' Core Principles includes, as essential criteria under Core Principle 2, that "the key objectives of supervision [is to] promote the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders" and "in the event that the law mandates or specifies multiple objectives for insurance supervision, the supervisory authority discloses and explains how each objective will be applied." For the International Organization of Securities Commissions' methodology states that "The three core objectives of securities regulation are: The protection of investors; ensuring that markets are fair, efficient and transparent; the reduction of systemic risk. Principle 1 requires that "the arrangements in place demonstrate the ability of the regulatory framework to create and implement a system intended to protect investors, provide fair, efficient and transparent markets, and reduce systemic risk." Thus, these stability concerns take clear precedence over other possible objectives. The Basel Core Principles for Effective Banking Supervision are less explicit on this point.

"punishes" self-interested behavior, would contribute importantly to making a European mandate more than hollow words.[31]

The accountability of the Level 3 committees themselves deserves re-examination in the context of introducing a European mandate. The most straightforward approach would be to enhance the accountability of Level 3 committees towards EU institutions. One element thereof would be regular reporting, as is now envisaged, but there may also be greater scope for transparency (perhaps through the publication of voting records and the issuance of more non-technical summaries of proceedings).

Since the relevant supervisory authorities take their powers and responsibilities from national parliaments, an essential step will be for those authorities to explain to those parliaments the nature of the European mandate, and actions taken to fulfill it. It should be possible to persuade those parliaments that the European mandate—even if not embedded in national legislation—is an extension of existing mandates. As mentioned above, conflicts of interest regarding financial system stability are likely to diminish over the long term, while the conflicts of interest that arise from economic nationalism and fiscal concerns are inconsistent with the authorities' existing mandates and countries' European commitments.

Supervisory authorities could also be answerable to the European Parliament to some degree. However, the European Parliament may be overwhelmed were scores of national authorities to report to it. Possibly, the European Parliament would have the right to request information and explanations from supervisors on how they have fulfilled their European mandates, rather than establish routine reporting.

The EU Commission could issue a periodic report on countries' efforts to fulfill the European mandate. Its reports on compliance with Maastricht budget conditions have had leverage. In the less politicized and more collegiate world of financial sector supervision, such leverage may be more effective. Eventually, use might be made of the Commission's enforcement powers. The Commission also has the staff resources to track and evaluate member states' actions. An alternative, more collegial approach would be to have the respective Level 3 committee prepare a regular report on its members through a system of peer review (as envisaged in the May 2008 ECOFIN conclusions). The Level 3 committee members have the technical expertise to conduct such reviews, and they are developing reporting procedures. This approach might be more politically acceptable to some member states, but could be open to mutual toleration of failings.

An important element of accountability is that towards the general public. Financial sector authorities could commit themselves to issuing periodic reports on their efforts to fulfill their European mandate, and invite public debate on the accuracy of their "European Impact

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[31] Hüpkes, Quintyn, and Taylor (*op. cit.*) provide an analysis of accountability mechanisms, which are further discussed in Masciandaro and Quintyn (2007).

Studies." Private sector bodies (financial institutions, consumer or industry groups) and indeed supervisors and governments from other countries could have a more active role to play in bringing forward cases of "non-cooperative" behavior by domestic supervisors. Given the analytic resources available to financial sector institutions and various research organizations, authorities would be forced to make a convincing case for their actions.

IV. Conclusions

A European mandate for national financial sector authorities could help produce decisions that are more timely and more conducive to promoting the common EU good. It would also help give EU cooperation operational priority at the national level, and provide a form of accountability for supervisors' increasing cross-border responsibilities. Thus, a European mandate could help build trust and cooperation, and enable supervisors to delegate increasingly to one another, which is necessary in an integrating financial market with decentralized prudential arrangements and numerous cross-border financial groups. In the absence of a European institution with supervisory responsibilities or powers to resolve problem institutions, national authorities need to be able to rely on each other without fear that everyone will look only to their narrow national interests. The recent financial sector crisis has amply demonstrated the need for more effective cooperation that is robust to strains in financial markets.

There is, however, a danger that a European mandate would become vacuous, making little difference in day-to-day practice and being disregarded during crisis situations. Introduction of a European mandate could even generate considerable pecuniary and non-pecuniary costs, notably confusion over responsibilities and powers. Avoiding these dangers requires concrete action on a number of issues:

- *How should a European mandate be formulated?* The mandate should center on financial sector stability but also recognize the need for efficiency, mainly in the sense of limiting regulatory burdens and not hindering innovation. One approach would be to define a broad European mandate, complemented by specific "dos and don'ts." This approach would help ensure that the mandate is flexible but also well-defined.

- *Which authorities should be covered?* At a minimum, the mandate should cover financial supervisory authorities and central banks, which are inevitably involved in supporting financial sector stability. Explicit European mandates should be given also to administrators or receivers of financial institutions in the context of a general strengthening of resolution frameworks. The Lamfalussy Level 3 committees themselves and deposit insurance schemes might benefit from receiving a European mandate.

- *How can a European mandate be established?* A very strong legal basis is necessary. National legislation could provide this, but risks adding complexities and undermining the unifying intent. Guidance from an EU Directive would therefore be desirable, while an EU Regulation could be another option, depending on how exactly treaty powers are interpreted.

- *How can a European mandate be put into practice?* Various practical measures taken by supervisors could help ensure that their European mandate permeates their day-to-day work and decision-making.

- *How to balance different mandates?* The European mandate may come into conflict with other mandates to which national agencies are subject, notably during the resolution phase of a crises. The European mandate should at least have precedence over any non-prudential national objectives of supervisors. More generally, some harmonization of mandates and the establishment of an explicit hierarchy might be desirable.

- *How to achieve accountability?* Strong accountability mechanisms are necessary to make a European mandate more than hollow words. Some combination of mechanisms toward the national and European levels would be preferable, so as to involve national parliaments while also ensuring oversight by institutions with an EU-wide perspective such as the European Commission and the European Parliament. Financial sector authorities should also report on their efforts to fulfill their European mandate to the public, thus allowing an active role by private sector bodies.

Appendix I: Recent EU Initiatives on a European Mandate for Supervisors

The October 9, 2007 ECOFIN meeting issued an ambitious set of conclusions on enhancing arrangements for financial stability in the EU. focusing on crisis management. Some elements include:

- A recognition that financial stability is a common concern for all member states that must be safeguarded on the basis of close cooperation.
- A set of common principles on cross-border financial management, which is recognized as a matter of common interest for all member states affected.
- An invitation to the ECOFIN to prepare an extended MOU by June 2008, which will detail common principles (notably on the management of a cross-border crisis), a common analytical framework and the timely sharing of assessments, and practical guidelines (see below).
- An invitation to the Commission to cooperate with the member states to consider including in the mandates of national supervisors a task to cooperate within the EU and the take into account the financial stability concerns of all member states.
- An invitation to the Commission to improve the interoperability of deposit insurance schemes and clarify the implications of sharing financial burdens.

The December 4, 2007 conclusions included various measures on supervisory cooperation, largely relating to the Lamfalussy process, and in particular provisions on:

- The risk of excessive national discretion in implementing EU Directives and for "Gold Plating." Therefore, member states are invited to report to the Commission on their use of discretion.
- A proposal that the Commission review differences in supervisory powers and objectives between national supervisors and with regard to sanctioning powers.
- The introduction of qualified majority voting Level 3 committees, where necessary.
- A suggestion that those who do not comply with Level 3 committee decisions provide a public explanation of their actions.
- The conclusions "underline the importance of considering" including in the mandates of national supervisors the task "to cooperate within the EU and to work towards European supervisory convergence and to take into account the financial stability of all member states."

The IIMG, established to assess progress in the Lamfalussy process, included in its final report the following recommendations:

- The Level 3 committees should be provided (a) with a clear EU mandate, complemented by an annual work program, which should be endorsed by the European Parliament, the Council and the European Commission, and (b) with a sufficient legal basis covering their activities.
- At national level, a clear requirement to cooperate at EU level and to support the EU convergence process should be included in mission statements of national regulatory and supervisory authorities.
- The Level 3 committees should serve as a platform for the coordination of supervision and regulation, facilitating the development of supervisory tools and methods, and strengthening the trust between national supervisors. One of their aims should be to enhance supervisory convergence and cooperation.
- When providing technical advice to the Commission, the Level 3 committees are (already) able to use a qualified majority voting procedure. The Group agreed that the committees should be permitted to use qualified majority voting for a limited number of tasks which are of a highly technical nature and where a delegation is given to the committees in Level 1 or (with the exception of one Member) Level 2 legislation. Other decisions on supervisory convergence should be taken by consensus and their implementation ensured by a strong "comply or explain" mechanism.
- Parliament, supervisors and the private sector should put forward complaints, information and concrete cases of incorrect implementation of EU rules.
- Transparency of national transposition of EU directives and implementation through disclosure mechanisms could curb regulatory additions and enhance convergence of practices through peer pressure.
- Improving enforcement of agreed legislation should become a common objective of all stakeholders. The Commission should play the principal role by using all available tools. Member States, the European Parliament, supervisors and the private sector should put forward complaints, information and concrete cases of incorrect implementation of EU rules.

The May 14, 2008 ECOFIN meeting confirmed and updated several of the initiatives noted above. Some of the main conclusions of meeting and elements of the updated “roadmaps” for further work on financial market supervision and stability arrangements include:

- The introduction of a “European dimension” into the mandates of national supervisory authorities. Member States are invited to ensure, by mid-2009, that the mandates of national supervisors allow them to take the EU dimension into account in exercising their duties. The task of financial supervisors should include cooperation at the EU level and among states.

- The introduction by the Commission of these objectives into EU legislation. For example, the Commission's current proposed amendments to the Capital Adequacy Directive includes clauses to the effect that supervisors in one state should have regard to the impact of their decisions on the stability of the financial system in all Member States; home supervisors should alert host supervisors as soon as they become aware of an emergency situation in a financial institution; and that consolidating supervisors should establish colleges of supervisors.

- An assessment by the Financial Services Committee of the application of the European dimension in national mandates, based on reports from the Level 3 committees.

- Strengthening the role of colleges of supervisors and their extension to all cross-border financial groups. The Level 3 committees are to provide guidelines to provide consistency and effectiveness in the work of the colleges.

- The Commission is to assess extensions of the "winding up directive" to facilitate the winding up of cross-border banking groups, taking into account the interests of all stakeholders.

The new MOU on cross-border financial crisis situations of June 2008 contains:

- A recognition that financial stability and managing a cross-border financial crisis are common concerns.

- An acceptance of the need for a common analytic framework for assessing systemic vulnerabilities and timely sharing of information.

- The introduction of a framework for cooperation agreements on arrangements for crisis management in the case of cross-border financial institutions. It is envisaged that "Cross-Border Stability Groups" be established; the groups would effectively expand colleges of supervisors by including Ministries of Finance and other agencies that would be involved in resolving a financial crisis.

- Agreement that collective crisis costs should be minimized and the distribution of costs of bank resolution should be equitable and balanced.

- A commitment to share information with counterparties in other member states as soon as an authority becomes aware of a potentially serious threat to financial stability. National authorities should share their information and assessments with one another.

In November 2008 a "High Level Expert Group on EU financial supervision" was established. The High Level Group, chaired by Jacques de Larosière, will make recommendations to the Commission on strengthening European supervisory arrangements covering all financial sectors, with the objective of establishing a more efficient, integrated and sustainable European system of supervision and also of reinforcing cooperation between European supervisors and their international counterparts.

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