Renewed Financial Supervision in Europe – Final or Transitory?

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INTRODUCTION

In order to obtain financial sector stability, adequate financial regulation and supervision are paramount. Despite their crucial role, both failed to prevent or at least mitigate the financial crisis. While financial regulation strives to impose a set of rules that ensure a safe and resilient financial sector, it has proven to contain too many gaps and loopholes[1].

Financial supervision, for its part, mainly aims to monitor whether or not the financial sector abides by the relevant rules. When this is not the case, or when financial stability is at stake, supervisors should be able to bring about an appropriate response. Across the globe, financial supervisors failed in their duties. The financial crisis has shown that supervisors were not able to properly detect or give warning of emerging problems.

In the EU, the mismatch between the financial sector and its supervision further compounded the supervisory failings. The EU's supervisory structure proved unable to cope with the integration of the financial sector. Already by 2005, 23% of all banking activity in Europe was of a cross-border nature, largely exceeding the levels of integration seen in the American and Asian-Pacific financial sectors[2]. Despite this increased integration and inter-dependency, financial supervision in Europe had remained almost exclusively a Member State affair.

Such asymmetry between supervision and financial sector integration does not necessarily impede effective supervision, but it does require intense cooperation between the different supervisors. This was neither the case prior to or during the financial crisis. When crucial decisions needed to be made at the EU level, national responses, nonetheless, prevailed.

The supervisory failings led to calls for major reforms, which resulted in a set of reforms that were fully put into effect in January 2011. It was welcomed as an area of significant progress of the post-crisis reforms. This paper discusses the EU financial supervision system that came about in the wake of the post-crisis reforms. By focusing on the powers and limits of the different supervisory levels, it aims to assess the system's chances of success.

[1] For the failures of financial regulation, see for example: BRUNNERMEIER, M., CROCKETT, A. (e.a.), The Fundamental Principles of Financial Regulation, Centre for Economic Policy Research, 2009.
[2] SCHOENMAKER, D., VAN LAECKE, C., Current State of Cross-Border Banking, LSE Financial Markets Group Paper Series, Special Paper 168, November 2006, p. 8

In the initial chapter, the paper discusses the former supervisory system. Chapter 2 provides a general overview of the reformed supervisory system. Subsequently, EU level supervision is detailed, both in terms of its macro-prudential arm (chapter 3) and its micro-prudential arm (chapter 4). The other parts of European supervision, both national and cross-border supervision, are the object of chapter 5. A conclusion draws together the relevant arguments and findings of this paper.

1. THE FORMER EU FINANCIAL SUPERVISORY SYSTEM

The European financial supervisory system that was in place on the eve of the financial crisis was the result of the continuous integration of the financial sector itself. Such integration required defining the responsible supervisor (see 1.1). These rules pose certain difficulties pertaining to the effectiveness of supervision and coordination between supervisors. Therefore, limited supervisory cooperation arrangements have been put in place (see 1.2).

1.1. The Home Supervisor Principle

Harmonisation of Member State legislation has contributed to the integration of the European financial sector[3]. Mutual recognition of financial institutions was put in place. This principle implies that a financial institution duly licensed in one Member State obtains a so-called passport, by which it can freely provide its services in the rest of the EU[4].

The integration of the financial sector required EU rules to determine which Member State is responsible for a given financial institutions. The result was home country supervisory control, which means that a financial institution is supervised by the Member State where it is licensed[5]. This includes the supervision of cross-border operations, as well as the operations of branches in other Member States. For example, the French supervisor oversees a French bank's branch in Austria, as well as its cross-border operations in Belgium.

[3] A first Directive aiming at harmonising the EU financial sector rules was already adopted in 1973, see: Directive 73/183/EEC, (OJ 1973 L 194/1-10). With regard to financial supervision, the Second Banking Directive is of importance, as it introduces home country supervision (cfr. infra), see: Directive 89/646/EEC, (OJ 1989 L386/1-13).
[4] Article 16 of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, OJ L 177, 30.6.2006, pp. 201–255
[5] Article 40 of ibid.

The home supervisor principle largely reduces the supervisory role of the host country. Supervision by the latter does not stretch much further than the supervision of a branch's liquidity provisions[6] and the collection of information for statistical purposes[7].

The situation is different however when a financial institution sets up a separate legal entity in another Member State, i.e. a subsidiary. As a subsidiary is conceived and licensed on its own, it is supervised by the country in which it was established. Nonetheless, the European harmonization process had facilitated the setting up of a subsidiary, which contributed to the entanglement of the European financial sector.

1.2.Limited Supervisory Cooperation

Despite the home supervisor principle, it was difficult for supervisors to have a complete image of the financial institutions that they were to supervise. Cooperation between supervisors proved indispensable. For this reason, supervisory cooperation arrangements had increasingly been put in place, both among individual supervisors and at the EU level.

1.2.1. Cross-border cooperation

EU rules stipulated that the home country supervisor should collaborate with the host state and provide it with the necessary information. While the rules required cooperation between national supervisors, they did not reduce the home country supervisor's competences[8]. In case of disagreement, the home country kept the final say.

In addition to EU legislation, supervisory collaboration and the common handling of crises had been outlined in several 'Memoranda of Understanding' between Member States. However, these Memoranda were by no means legally binding. This was particularly apparent during the financial crisis. Member States were inclined to circumvent the established channels of cooperation and opted rather for unilateral responses[9].

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[6] Article 41 of ibid.
[7] Article 29 of ibid.
[8] Article 42 of ibid.
[9] CIHAK, M., DECRESSIN, J., The Case for a European Banking Charter, IMF Working Paper, July 2007, WP/07/173, pp. 6-7

Other, more elaborate ways of cooperation were equally developed, notably colleges of supervisors (see 5.1). Despite their potential, only a handful had been created prior to the crisis. Those in place were still in their test phase when the financial crisis broke out and thus proved to be of little use[10].

1.2.2. EU level cooperation

A number of EU bodies have been created to support national supervision. In the European Central Bank, the Banking Supervision Committee (BSC) had been established. It groups officials from the ECB, the national central banks and the banking supervisors[11]. The BSC assisted central banks in two fields: the supervision of credit institutions and financial system stability[12]. As the BSC was only to provide a supporting role, it did not have any legally binding means at its disposal. The BSC's role and competences have remained unaltered by the post-crisis reforms[13].

The 2001 Lamfalussy Report[14] had an important impact on EU involvement in financial supervision. The Report led to the creation of a four level structure to adopt and implement financial regulation. Of this structure, the third level plays a particularly pertinent role with regard to financial supervision. At this level, three sectoral committees were put in place, grouping respectively the national supervisors of the banking sector[15], the securities sector[16] and the insurance and occupational pensions sectors[17]. The tasks of these Lamfalussy level 3 Committees expanded over the years. Eventually, the Committees' main tasks were (1) facilitating mediation between supervisors, (2) contributing to the consistent implementation of Union directives, (3) reviewing and converging supervisory practices and (4) enhancing information exchange and supervisory coordination[18]. The Lamfalussy level 3 Committees were to pursue these tasks using non-binding

[10] CEBS, Range of Practices on Supervisory Colleges and Home-Host Cooperation, December 2007, Retrievable on : http://www.eba.europa.eu/getdoc/2a41c4f5-f76c-4c53-a790-fcd8cd129bbb/CEBS-2007-75-(Range-of-practices)-final.aspx

[11] The Committee was established in 1998 and succeeded the Banking Supervisory Sub-Committee, which had been created by the Committee of Governors committee created in 1990.

[12] SCHELLER, H., European Central Bank. History, Role and Functions, European Central Bank, 2006, pp.111-113

[13] This is contrary to the de Larosière Group's recommendations, which proposed to replace the BSC by the new macro-prudential supervisory body (see 3).

[14] Lamfalussy Committee of Wise Men, Final Report on the Regulation of European Securities Markets, 15 February 2001

[15] The Committee of European Banking Supervisors (CEBS), established by Commission Decision 2004/5/EC of 5 November 2003, OJ L 3, 7.1.2004, pp. 28–29

[16] The Committee of European Securities Regulators (CESR), established by Commission Decision 2001/527/EC of 6 June 2001, OJ L 191, 13.7.2001, pp. 43–44

[17] The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), established by Commission Decision 2004/6/EC of 5 November 2003, OJ L 3, 7.1.2004, pp. 30–31

[18] See Article 4 of Commission Decisions 2009/77/EC, 2009/78/EC and 2009/79/EC (OJ 2009 L 25/18-32)

instruments[19]. Moreover, decisions by the Committees were to be made by unanimity. Only when a consensus was not feasible could decisions -by way of exception- be taken by a qualified majority.

These bodies were not without any value. However their reliance on non-binding instruments did not enable them to gain enough influence on financial supervision in the EU, let alone steer it through times of trouble.

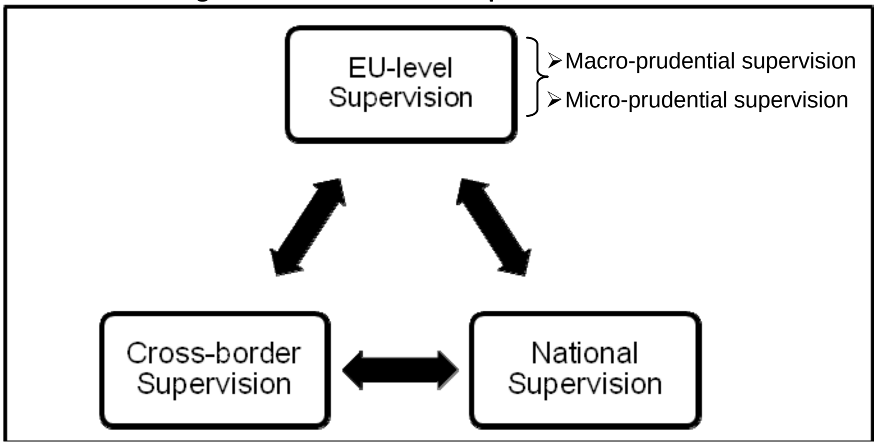
[19] See Article 3 of ibid.

2. OVERVIEW OF THE RENEWED EU FINANCIAL SUPERVISORY SYSTEM

During the financial crisis, it became clear that the EU's supervisory arrangements were too limited to ensure a stable and resilient financial sector. Such an ineffective financial supervisory regime is incompatible with a well-functioning internal market. As the negative effects of the financial crisis grew, so did the willingness to modify the supervisory system. This led to a set of reforms, which fully entered into force in January 2011.

The reforms have notably led to the creation of the European System of Financial Supervision (ESFS), which consists of both the national supervisory authorities and the European supervisors[20]. Cross-border supervisors remain outside of the ESFS, but equally play a noteworthy role in the renewed financial supervisory system. Figure 1 provides an overview.

Figure 1: The EU financial supervision structure



EU level supervision has been assigned a bigger role than was previously the case. It now comprises two types of supervision. The first type is macro-prudential supervision, which aims to monitor the overall stability of the financial system. This task is carried out by the European Systemic Risk Board (ESRB) and is discussed in the following chapter. The second type of EU level supervision concerns micro-prudential issues, i.e. the individual financial institutions. To this extent, three European Supervisory Authorities (ESAs) have been created, each responsible for a segment of the financial sector (see 4.).

At the cross-border level, the colleges of supervisors have been attributed a more significant role than was the case before the supervisory reform. They have been made mandatory for cross-border financial groups. This should stimulate coordination and collaboration among supervisors (see 5.1).

[20] Article 1(3) of Regulation (EU) No 1094/2010, op. cit. footnote 39

Finally, national level supervisory responsibilities have undergone change, albeit to a lesser degree. These minor changes, as well as the reinforcement of cross-border and EU supervision, have not altered the fact that home country supervisors remain in firm control of financial supervision (see 5.2).

3. EU MACRO-PRUDENTIAL SUPERVISION

One of the major innovations brought about by the new supervisory set-up is the creation of the European Systemic Risk Board (ESRB), which is an EU level body responsible for macro-prudential supervision. In light of the failures of pre-crisis financial supervision, such a body was much-needed.

3.1. Tasks

The ESRB's mission is to supervise the financial system in order to prevent or mitigate systemic risk. Systemic risk is a broad concept, which the relevant Regulation defines as "*a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy*[21]". This definition remains vague about the precise nature of a systemic risk, giving little detail on what constitutes a disruption or what separates serious negative consequences from more benign ones. This ambiguous definition might to some extent be deliberate, allowing the ESRB to adapt to future evolutions.

To carry out its mission, the ESRB needs first of all to supervise and detect potential or existing systemic risk in the financial system. Despite its major supervisory task, the ESRB is not allowed to perform direct supervision, i.e. demand information from individual financial institutions. It relies completely on data collected by external sources.

As a second task, the ESRB is to emit warnings and recommendations when believed necessary. These can be emitted if the ESRB finds that there is a significant risk of systemic failures or reduced resilience of the financial system. The warnings and recommendations are non-binding. If felt necessary, the ESRB can nonetheless decide to make them public. This 'name-and-shame' option should be regarded as the ESRB's ultimate weapon, only to be employed when all else fails.

Finally, the ESRB is to provide follow-up on its recommendations. Those to whom a recommendation is addressed need to communicate the corrective actions they take or explain the lack thereof. This

[21] Article 2(c) of Regulation (EU) No 1092/2010, of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, OJ L 331, 15.12.2010, pp. 1–11

requirement is referred to as the 'act-or-explain' approach. In contrast to recommendations, no formal follow-up is foreseen for warnings.

3.2.Decision-making

Normal decision-making in the ESRB's General Board consists of voting by simple majority. In addition, a quorum of two-thirds is required. However, an extraordinary meeting can be held if the General Board fails to meet this quorum. During such extraordinary meetings, decisions can be adopted with a quorum of one-third[22]. Making warnings and recommendation public is an exception to these general decision-making rules, as it requires a two-thirds majority and a fixed quorum of two-thirds[23]. Despite these arguably lenient majority rules, the ESRB is most likely to pursue a large consensus before emitting warnings and recommendations (see 3.3.2).

3.3.Limits

Notwithstanding the importance of the ESRB's tasks, it faces several hurdles that could prevent it from being effective. The limitations discussed below are likely to become even more important as time passes and the sensed need for effective supervision diminishes.

3.3.1. Lack of coercive power

As a first limit, the ESRB cannot oblige others to take its recommendations and warnings into account. It therefore constitutes a soft law body. Such bodies can be influential, but national, regional and international examples show that this is challenging[24].

The ESRB has some strong points when drawing comparisons with other soft law bodies. It is part of the EU, which has binding powers - in contrast to many international organisations. It furthermore has some means of stimulating compliance, notably through the 'act-or-explain' approach and its powers to publicly name and shame. EU Institutions and national supervisors also have the obligation to cooperate with the ESRB[25]. If they fail to do so, this can be viewed as a violation of their

[22] Article 10 of ibid.
[23] Article 18(1) of ibid.
[24] See FERRAN, E., KERN, A., Can Soft Law Bodies be Effective? Soft Systemic Risk Oversight Bodies and the Special Case of the European Systemic Risk Board, Working Paper Series, November 2010, Retrievable on: http://ssrn.com/abstract=1676140
[25] Article 15 (1) of Regulation (EU) No 1092/2010, op. cit. footnote 21

obligations under EU law[26].Finally, the to-be introduced Excessive Imbalance Procedure can equally help the ESRB to be influential[27].

Even so, these strengths are on their own unlikely to sufficiently ensure any meaningful influence. In the end, the ESRB is to rely for a major part on its reputation, instead of on coercive powers. As a consequence, the ESRB will continuously need to labour for its voice to be heard.

3.3.1. A more than challenging task

It's clear that the ESRB faces a daunting task. Whether deliberate or not, its mandate remains vague. This leaves some important questions unanswered. It is not clear whether the ESRB's mission entails supervision of the financial sector as such or whether it is to take into account other macro-economic evolutions, most notably asset prices. Moreover, the ESRB's role in crisis situations has not been determined, despite insistence by the Economic and Financial Committee[28].

Even with a better-defined mandate, the ESRB's task would be challenging - especially if we take into account the ESRB's other limits. In essence, the ESRB risks failing to perform its core tasks in the two ways. On the one hand, it may fail to warn of a systemic risk. To this extent, many of the problems with regard to the former supervisory system remain present after the reforms: providing an assessment of macro-prudential risk remains an intellectually challenging task and policymakers will continue to be doubtful of warnings that could undermine short-term growth. On the other hand, the ESRB could fail its tasks by erroneously identifying a situation as posing a systemic risk and thus unduly undermine growth.

Supervision is not an exact science and hence entails an element of uncertainty. Therefore, the two types of mistakes are to some extent unavoidable. While erroneous warnings might seem less harmful than failing to warn of a systemic risk, multiple erroneous warnings could undermine the ESRB's reputation and thus its relevance[29].

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[26] FERRAN, E., KERN, A., Can Soft Law Bodies be Effective?, op. cit. footnote 24 , pp. 30-31

[27] European Commission, Proposal for a Regulation on enforcement measures to correct excessive macroeconomic imbalances in the euro area, COM (2010) 527, 29 September 2010

[28] EFC High-Level Working Group on Cross-Border Financial Stability Arrangements, Lessons from the financial crisis for European financial stability arrangements, 8 July 2009, p.11

[29] SMAGHI, L., Speech at the CEPR/ESI 13th Annual Conference on 'Financial Supervision in an Uncertain World', European Banking Center at Venice International University,
Venice, 25-26 September 2009, Retrievable on:
http://www.ecb.int/press/key/date/2009/html/sp090925.en.html

3.3.2. Sizeable General Board: balancing consensus and substance

The size of the ESRB's General Board, which has 66 members, renders the work of the ESRB even more complicated. It is unmistakably difficult to discuss macro-prudential matters with so many participants around the table. This is especially true given that the ESRB discusses sensitive, confidential matters. The former EU supervision bodies proved to be inappropriate forums for exchanging information, due to their broad membership[30]. Yet, under the current structure, the EU is certain to repeat previous mistakes. There is a real risk that the functioning of the ESRB will be hampered as a consequence[31].

Besides difficulties in exchanging information, the size of the General Board will also make it more difficult to agree on evocative warnings. Here, the ESRB faces a considerable dilemma. If its messages are to have a reputational effect, it should adopt texts with a large consensus. When warnings or recommendation lack consensus inside the Board, their validity can easily be questioned. On the other hand, a consensus among so many participants is likely to lead to watered-down texts, rendering them less meaningful. For the ESRB, it will be a difficult to deliver documents that are both consensual and substantive.

3.3.3. Strong reliance on central banks

While the ESRB's membership is inclusive in terms of Member State representation, it is less so in sectoral terms. The ESRB is dominated by central bankers and the role of non-central bank supervisors has as a consequence been limited considerably. In the General Board, more than three out of the four voting members are central bankers. Furthermore, the large role of the ECB in the ESRB's secretariat strengthens central banks' presence. The need for a balanced territorial representation seems to have been detrimental to both the size of the General Board and the sectoral representation inside the ESRB. Other bodies that carry out macro-prudential supervision are less dependent on central bankers. The international Financial Stability Board for example has a wider range of members, including finance and economy ministries[32].

[30] EFC, Lessons from the financial crisis, op. cit. footnote 28
[31] SIBERT, A., Systemic Risk and the ESRB, European Parliament Note, 2009, p.6
[32] See: FSB Member Institutions, retrievable on: http://www.financialstabilityboard.org/members/links.htm

The lack of diverse sectoral representation can hinder the ESRB's ability to detect and respond to systemic risks. While central bankers have useful information and knowledge, they lack expertise in certain fields and do not bear responsibility for financial sector crisis management[33].

Equally worrying is the fact that financial stability can conflict with central bankers' main objective: inflation targeting. For example, tighter monetary policy might be advantageous for inflation reduction, but it could also run the risk of undermining financial stability. Conversely, providing liquidity to distressed financial institutions may stabilise the financial system, but it can also lead to rising inflation[34]. This conflict of interest could potentially lead to Board members neglecting their responsibilities as members of the ESRB's General Board, which is for most of them after all only a secondary responsibility.

3.3.4. Legal issues

The legal basis for the creation of the ESRB is contained in Article 114 TFEU. This article allows for "*measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market*". A legislative act based on Article 114 TFEU hence needs to fulfil two requirements: 1) it needs to contribute to the approximation of Member State provisions and 2) it should contribute to the internal market.

The second requirement seems met, although rather indirectly. The first condition is more problematic. It is uncertain whether the ESRB Regulation, even indirectly, contributes to the approximation of Member State provisions. The Advisory Committees in the ESRB do to some extent have a role in approximating Member State provisions, but this role was not provided for in the ESRB Regulation. Although the European Court of Justice has shown leniency in the matter, it equally stated that the contribution to the approximation of market conditions needs to be substantial, going beyond a mere "*incidental effect*[35]". The act should equally alter the normative content of Member State provisions[36]. Here within lies the potential contradiction of the ESRB Regulation with EU law. It is unclear how the ESRB alters the content of Member State provisions, as it isn't the ESRB's

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[33] Treasury Committee of the UK House of Commons, Opinion on Proposals for European Financial Supervision, Session 2008–09, Sixteenth Report, 2009, pp. 18-19

[34] DE GREGORIO, J., Recent challenges of inflation targeting, pp. 9-13, In: Perspectives on inflation targeting, financial stability and the global crisis, BIS Papers No 51, March 2010

[35] Paragraph 35 of Judgment of the Court (Sixth Chamber) of 18 November 1999, Commission of the European Communities v Council of the European Union, Case C-209/97, European Court reports 1999 Page I-08067,

[36] Paragraph 28 of Judgment of the Court of 9 October 2001, Kingdom of the Netherlands v European Parliament and Council of the European Union, Case C-377/98, European Court reports 2001 Page I-07079

objective, nor is it endowed directly or indirectly with the competences to do so. This possible contradiction has the potential to undermine the ESRB's future.

4. EU MICRO-PRUDENTIAL SUPERVISION

While macro-prudential supervision is an important aspect of supervision, it can by no means replace the supervision of individual financial institutions, referred to as micro-prudential supervision. Such supervision constitutes the first line of defence against any financial sector difficulties.

The three European Supervisory Authorities (ESAs) constitute the most important elements of EU-level micro-prudential supervision. They replace the former Lamfalussy level 3 Committees[37]. Each of the ESAs deals with a specific subset of the financial sector, namely:

- the European Banking Authority (EBA): responsible for the banking sector[38];
- the European Insurance and Occupational Pensions Authority (EIOPA): responsible for the insurance and occupational pensions sector, including pension funds[39];
- the European Securities and Markets Authority (ESMA): responsible for the securities sector and financial markets[40].

The micro-prudential arm of EU supervision also comprises a Joint Committee of ESAs and a Board of Appeal. The former is to deal with cross-sector issues and is composed of representatives of the three ESAs. The latter should allow for a timely contestation of ESA decisions, preceding an often cumbersome procedure before the European Court of Justice.

Mirroring the discussion on macro-prudential supervision, this chapter begins with an overview of the tasks (4.1) and decision-making rules (4.2) of EU micro-prudential supervision. The chapter concludes by focussing on the limits of EU micro-prudential supervision (4.3).

[37] See 1.2.2.

[38] See Article 1(2-3) of Regulation (EU) No 1093/2010 of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, OJ L 331, 15.12.2010, pp. 12–47, hereinafter EBA Regulation

[39] See Article 1(2-3)Regulation (EU) No 1094/2010 of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, OJ L 331, 15.12.2010, pp. 48–83, hereinafter EIOPA Regulation

[40] See Article 1(2-3) of Regulation (EU) No 1095/2010 of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, OJ L 331, 15.12.2010, pp. 84–119, hereinafter ESMA Regulation

4.1.Tasks

The ESAs have a wide range of tasks to fulfil. The ESAs' actual powers vary considerably from task to task. In several domains the ESAs have rather extensive competences.

A first important task of the ESAs is to work towards a single EU rule book. Such a single rule book should lead to less divergent financial legislation across Member States. However, it does not imply a complete harmonisation of all rules applicable to financial institutions. The ESAs have two instruments at their disposal to achieve the single rule book: adopting non-binding guidelines and recommendations, and developing draft binding technical standards that are subsequently endorsed by the Commission.

The ESAs have, as a second substantial competence, a role in ensuring the enforcement of EU rules. The ESAs can counteract breaches of EU law by national supervisors. The ESAs furthermore have an active role in settling disagreements between national authorities. In both cases the ESAs can, if certain conditions are met, address individual financial institutions.

Thirdly, the ESAs are to improve the handling of distress in the financial system. The ESAs can review contingency planning arrangements and adopt draft technical standards on the matter. They are also to initiate and coordinate stress tests. Furthermore, the Council can declare an emergency situation, during which the ESAs have the power to require actions by national supervisors and if needed by financial institutions. In specific cases the ESAs are even able to temporarily restrict or ban financial activities.

Last but not least, the ESAs are to be responsible for the supervision of some financial actors. The ESAs will conduct direct supervision of specific financial actors, such as credit rating agencies and derivative trade repertories. Yet, important to note is that the ESAs are not allowed to carry out day-to-day supervision of other financial institutions, which is the sole responsibility of national supervisors[41].

The ESAs' other tasks are of a more limited nature. Two are worth noting. On the one hand, the ESAs are tasked to advance supervisory cooperation and convergence, a role they inherited from the former Lamfalussy level 3 Committees. On the other hand, the ESAs play a role in consumer protection. The ESAs' competences involve consumer protection in the narrow sense, as well as contributing to national guarantee schemes aimed at insuring the public against unlikely, but harmful events.

[41] Recital 9 of EBA and ESMA Regulations, op. cit. footnote 38 and 40 and Recital 8 of EIOPA Regulation, op. cit. footnote 39

4.2.Decision-making

As a general rule, decisions by the ESAs' Board of Supervisors, where each national supervisor has one vote, are taken by a simple majority of its members. In a Union of 27, this implies that a decision can be passed when supported by 14 national supervisors. Stricter majority rules have been put in place with regard to more comprehensive competences. Table 1 provides an overview of the exceptions.

Table 1: Matters where the General Board's majority rule differs from the majority of the members rule

Matter	Majority rule
Technical standards	Qualified majority
Guidelines and recommendations	Qualified majority
Financial provisions	Qualified Majority
Binding settlement of disagreements concerning consolidating supervisor decisions	Simple majority, unless blocking minority
Reconsideration of a decision to ban or restrict a financial activity	Qualified majority

By deciding most issues by simple majority, the ESAs can take decisions more easily than previously was the case – when unanimity was preferred. The exceptions make the use of the ESAs' most significant competences more difficult. At the same time, they ensure broad support for these decisions, which makes sense. Nevertheless, it seems detrimental that political compromises lead to an unnecessarily complicated set of decision-making rules.

4.3.Limits

Despite the ESAs' comprehensive tasks and not so very demanding decision-making rules, its limits should not be overlooked. These do not only reduce the ESAs' current role, but equally pose limits to the role that the ESAs can be attributed in the future.

4.3.1. Limited supervisory role

Although the supervisory reform transformed the previous Lamfalussy level 3 Committees into European *Supervisory* Authorities, the actual supervisory role of these Authorities remains limited. They are only entitled to collect information and monitor market developments, lacking the competence to conduct day-to-day supervision. Furthermore, even if the ESAs were to detect a problem in a financial institution, they would only be able to force national supervisors or financial institutions to act when directly applicable EU rules are violated or when an emergency situation was declared. In other situations, it would be much more difficult for the ESAs to have a significant influence.

Considerable direct EU supervision is currently inconceivable. Supervision is undeniably linked to financial sector crisis management and lender of last resort responsibilities, which have to take over when supervisors have failed to perform their tasks. For this reason, responsibility for financial supervision ought to be in line with fiscal responsibilities in crisis situations[42]. Currently, Member States carry the burden of crisis management (see 4.3.3). Shifting supervision from the Member States to the EU without resolving the burden-sharing issue would be rightly unacceptable for Member States. Furthermore, legal issues equally prevent the ESAs to take-up more direct supervisory tasks (see 4.3.5).

4.3.2. Procedural constraints

The ESAs have been endowed with considerable, binding competences. Yet, the use of their competences is restricted, due to lengthy procedures and/or the needed go-ahead by an EU Institution. This is made clear by an overview of the ESAs' constraints when applying five of its most significant competences:

1) The emergency powers of the ESAs can only be used after the Council declares an emergency situation, which it will not do lightly. Furthermore, decisions by the ESAs may not have a considerable impact on the Member States' fiscal responsibilities (see 4.3.3).
2) The ESAs' technical standards are drafts. They need to be endorsed by the Commission and even then they can be rejected by the either the Council or the European Parliament.
3) With regard to counteracting a breach of EU law, the ESAs can only impose their decisions upon financial institutions and national supervisors when the Commission adopted a formal opinion. Additional requirements need to be fulfilled before an ESA can address a financial institution.
4) When settling a disagreement between national supervisors, the ESAs must allow for a conciliation phase, which can take considerable time. After this phase it first has to address the national supervisors before it can require action from individual institutions. At any rate, the ESAs' decisions may not have considerable impact on the Member States' fiscal responsibilities (see 4.3.3).
5) An ESA can only ban or restrict a financial activity if specifically foreseen by EU legislation or when an emergency situation is declared. If an ESA bans or restricts a financial activity, any Member State can request a confirmation of this decision. In that case, a qualified majority in the ESA's General Board is needed to confirm the decision.

[42] GOODHART, C., Some New Directions for Financial Stability?, Per Jacobsson Lecture, Bank for International Settlements, 2004, pp.7-8

As a consequence, most of the ESAs' binding powers are only to serve as instruments of last resort and thus used scarcely. The ESAs' competence to adopt draft technical standards is an important exception and is likely to constitute one of the ESAs' most prominent competences.

4.3.3. Safeguards protecting national fiscal autonomy

A safeguard clause was introduced into the Regulations[43]. The clause limits the fiscal repercussions of ESA decisions in two fields: emergency situations and the settlement of disagreements. In both fields, the safeguard clause stipulates that an ESA decision shall not impinge on a Member States' fiscal responsibilities, thus limiting the pecuniary repercussions of the ESAs' decisions. This is especially relevant in case of a bail-out of a cross-border financial institution. During the financial crisis, Member States were almost never able to agree on burden sharing arrangements when financial institutions needed to be refinanced. Due to the safeguard clause, the ESAs will be little more than a forum for such agreements.

The safeguard clause is initiated by the non-implementation of an ESA decision by a Member State on grounds of its fiscal impact on that Member State. The ESA decision is then immediately suspended. The procedure that follows depends on whether the safeguard clause is used in an emergency situation or in case of the settlement of a disagreement, with some similarities existing between the two. In a nutshell, when settling disagreements, an ESA decision is revoked unless a majority of Member States supports the ESA decision. If an emergency situation has been declared, than the opposite applies. In such instances, an ESA decision is maintained unless the Council decides otherwise.

4.3.4. Budgetary and staffing constraints

Unlike the ESRB, the ESAs have their own budget. The ESAs' resources come from national supervisors (60%) and from the Union budget (40%)[44]. In addition, legislators can require fees from the financial sector, which then are supplemented to the ESAs' budgets. This is the case for credit rating agencies, whose fees will be added to the ESMA budget[45]. It has been argued that the ESAs' budgets and staff are very small compared to the tasks they have to perform[46]. Table 2 shows the ESAs' initial 2011 budget and their 2015 budget, when the ESAs are to be fully operational.

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[43] Article 38 of ESA Regulations, op. cit. footnotes 38-40
[44] Recital 68 and Article 62 of ESA Regulations, op. cit. footnotes 38-40
[45] European Commission, Proposal for a Regulation on amending Regulation (EC) No 1060/2009 on credit rating agencies, 2 June 2010, COM(2010) 289 final
[46] Remarks by LANNOO, K., Debriefing on European Parliament Decision on the Financial Supervision Package, Centre for European Policy Studies, 27 September 2010

Table 2: ESAs' 2011 and 2015 budgets in EUR[47]

ESA / Year	2011	2015
EBA	12.682.500	24.591.000
EIOPA	10.667.500	19.955.000
ESMA	19.460.000	23.785.000
Total	42.810.000	68.331.000

A total 2015 budget of over EUR 68 million might seem impressive, but compared to national supervisors' budgets this is in fact rather small. The British Financial Services Authority's 2009 operating costs were approximately EUR 450 million[48] and the German BaFin budget was EUR 129 million[49]. This is also reflected in terms of staff. By 2015, the combined staffing of the ESAs will be around 300, in contrast to the 3.300 employees of the British Supervisor[50]. Of course, a comparison between the EU and the national level is imperfect, as the two levels have different tasks. What the figures in any case do show is that national supervisors are by far the more dominant bodies.

4.3.5. Legal issues

The ESAs' legal nature could pose difficulties. The ESAs are created as EU agencies, each with a distinct legal personality. Delegating powers to independent agencies poses certain issues concerning accountability, a subject frequently discussed in economic and political theory. Therefore, the delegation of tasks is often subjected to control mechanisms and delegation limits.

In the EU such issues arise as well, as agencies operate outside of the institutional framework provided by the Treaty[51]. Case law has filled in this legal gap. The 1958 Meroni Cases are of crucial

[47] The 2011 figures are based on the EU 2011 budget, plus national contributions and sectoral fees in case of the ESMA. 2015 figures are based on the Commission's proposal, see: European Commission, Proposal for a regulation establishing a European Banking Authority (EBA) of 23 September 2009, COM (2009) 501 final.
[48] The FSA's operating costs for the period 1 April 2009 to 31 March 2010 were £391.7 million, see: FSA, Annual Report 2009/2010, June 2010, p. 67, Retrievable on: http://www.fsa.gov.uk/pubs/annual/ar09_10/ar09_10.pdf
[49] BaFin, Jahresbericht der BaFin ´09, April 2010, p.255, Retrievable on: http://www.bafin.de/cln_171/nn_992916/SharedDocs/Downloads/DE/Service/Jahresberichte/2009/jb__2009__gesamt,templateId=raw,property=publicationFile.pdf/jb_2009_gesamt.pdf
[50] European Commission, Financial Supervision Package - Frequently Asked Questions, 22 September 2010, MEMO/10/434
[51] ANDOURA, S., TIMMERMAN, P., Governance of the EU: The Reform Debate on European Agencies Reignited, EPIN Working Paper, nr. 19, 2008, p.5

importance[52]. They set out multiple conditions for the establishment and functioning of agencies, which have become known as the *Meroni Doctrine*.

The conditions of the Meroni Doctrine are quite stringent. In case of the ESAs, two interlinked conditions are of particular are particularly pertinent. As a first condition, the delegation of power can only involve clearly defined executive powers[53]. Secondly, any assessment by an agency on its own authority must be subject to precise rules so as to exclude arbitrary decision-making[54].

An initial difficulty is the scope of the ESAs' competences. As previously outlined, the ESAs can settle disagreements, enforce EU rules, ban financial activities and oblige financial supervisors and institutions to take emergency situation measures. One might wonder if these powers are mere executive ones, even taking into account their rare use and the procedural constraints. At any rate, they stretch far beyond administrative tasks.

The second potential area of difficulty concerns the ESAs' margin of appreciation when it comes to decision-making. Most often, the Regulations only indicate that the ESAs' decisions must be made in accordance with the applicable legislation and/or to ensure compliance with Union law it. Such general references might be considered to be different from precise assessment rules. Furthermore, in some cases the ESAs have the possibility – not the obligation– of addressing financial institutions in case a national supervisor fails to comply[55]. This seems to leave the ESAs some leeway when choosing the course of action. The fact that a Board of Appeal has been created equally indicates that the ESAs' decisions or lack of decision entail a certain margin of appreciation.

In light of these issues, it seems that the ESAs' competences are on the edge of what is legally feasible. Without passing a final judgement on the matter, it seems presumptuous to assume that the European Court of Justice would undoubtedly accept the delegation of powers to the ESAs. A renewed view of the Court of Justice on the delegation of powers could present a legal milestone. Accepting the ESAs' set-up could lead to an increased role for EU agencies. However, if the Court finds the ESAs' powers to be in violation of EU law, it could undermine the role of the EU in micro-prudential supervision and put the legal arrangements of several other agencies into question as well. Such consequences could be far reaching.

[52] Joined Cases 9-56 and 10-56 Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community
[53] Paragraph 8 of Summary of Judgment of the Court of 13 June 1958, Meroni & Co., Industrie Metallurgiche, SpA v High Authority of the European Coal and Steel Community, Case 9-56
[54] Paragraph 7 of ibid.
[55] For example, ESAs are left the choice in case of a breach of EU law and in emergency situations.

5. NATIONAL AND CROSS-BORDER SUPERVISION

While the legislative reforms draw attention to EU level supervisors, they are in no way the only supervisors operating in the EU. In fact, EU supervisors form only a small part of the European supervisory landscape. Actual supervision of financial institutions is carried out by other supervisors. With regard to cross-border supervision, the role of colleges of supervisors has been strengthened (5.1). Yet, these colleges and the EU supervisory bodies have not replaced the pivotal role of national supervisors (5.2).

5.1.Cross-border Colleges of Supervisors: Strengthened, but Feeble

Alongside the EU supervisors, colleges of supervisors are likely to be one of the main innovations in financial supervision resulting from the financial crisis. Such college of supervisors brings together the different supervisors of the Member States in which a given financial institution or conglomerate operates. In these colleges, national supervisors are to strive towards a consensus on supervisory decisions regarding a financial institution. As a consequence of the financial crisis, colleges of supervisors have become mandatory for multinational financial institutions[56]. More than 100 supervisory colleges had been created in the European Economic Area[57].

The rise of colleges of supervisors is an important progress. Indeed, close cross-border cooperation between supervisors is vital. Yet, their weakness lies in the voluntary nature of cooperation. While a home country supervisor needs to take the opinion of other supervisors into account, they ultimately have the final say. A college of supervisors does, therefore, not substitute national supervision. Rendering the colleges mandatory is a first step towards closer cooperation. Providing the ESAs with mediation competences is another important step. However, neither guarantees effective cross-border supervision. For this, more binding forms of supervisory coordination would have to be envisaged.

[56] Article 131a of Directive 2006/48/EC of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions [recast], OJ L 48, 30.3.2010, pp.1-252. This obligation applies to financial institutions that are supervised by a consolidating supervisor; see Article 42a of the Directive.

[57] CEIOPS, List of groups for which a College of supervisors is in place, February 2010, Retrievable on: https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/20100201-CEIOPS-List-of-groups-with-a-college-of-supervisors-in-place.pdf

5.2.National Supervision: Where the Actual Power Lies

Although the national supervisors are at the bottom of the supervisory system and have diverging structures[58], they continue to stretch out far above others supervisors in terms of competences. The main task of national supervisors is to carry out day-to-day micro-prudential supervision, i.e. verify whether individual financial institutions are abiding by the relevant rules and are in sound financial health. They thus carry out the bulk of supervision related work.

Not only do national supervisors undertake the bulk of supervision tasks, they are also the central figures in the cross-border and European supervisory bodies. Colleges of supervisors are almost exclusively made up of the relevant national supervisors. National representatives equally dominate the EU bodies.

Despite their pivotal role, national supervisors' powers still have their limits. The enhanced competences of EU micro-prudential supervisors imply that national supervisors can be overruled. Furthermore, the single rule book and the coordination of supervisory practices will reduce the national supervisors' discretionary powers. National supervision will increasingly be determined by the EU level. However, a shift from national to European supervision is as of now unfeasible[59].

CONCLUSION

The renewed financial supervision system has substantially altered the way in which financial supervision is carried out. The reforms were undeniably needed, and should be welcomed. Similar changes would have been inconceivable before the financial crisis.

Of crucial importance is the enhanced role of the EU level actors. At the macro-prudential level, the European Systemic Risk Board (ESRB) has been created to monitor the overall financial stability of the financial sector. At the micro-prudential level, former supervisory bodies have been revamped into European Supervisory Authorities (ESAs). The ESAs have been attributed significant competences, which are even set to gradually increase over time.

Despite their increased role, these EU level bodies do face certain limitations. The ESRB has no binding competences. Its success is, therefore, strongly dependent on the willingness of the Member States to act upon its warnings and recommendations. The ESAs' role is largely limited to undertaking

[58] ECB, Recent Developments in Supervisory Structures in the EU Member States (2007-10), October 2010, pp.1-5

[59] As aforementioned, the European micro-prudential supervisors face several limits; see in particular 4.3.1 Limited supervisory role and 4.3.5 Legal issues.

and promoting supervisory cooperation and legislative harmonisation. Their function in actual supervision is limited. Moreover, the instances in which the ESAs' decisions may have a sizable impact on Member States' budgets have been limited, hampering their role in crisis management.

Besides a strengthening of the EU level, some steps have equally been taken to enhance cross-border. Cross-border colleges of supervisors have been made mandatory. Nonetheless, these bodies have few means to trigger policy responses, even less than the ESRB.

Despite the increased role of other bodies, national supervisors continue to be the core elements of financial supervision. Only they have both substantive supervisory tasks and the competences to enforce their decisions. Moreover, the cross-border and EU level supervisory bodies consist mostly of national supervisors. Those bodies can, therefore, not be considered supranational entities.

As a result, the asymmetry between national financial supervision and the European integration of the financial sector remains. The sustainability of such asymmetry should be a major focus of the future review, to be completed in 2014. After this, it is highly likely that the opportunity for post-crisis reform will be over.

If the review finds that a renewed supervisory system could result once again in substantial supervisory failings, more drastic reforms are to be envisaged. This could lead to the Europeanization of financial supervision. It would result in a further loss of national autonomy and would require a genuine EU approach to financial sector crisis management. More EU supervision could equally require a change in the EU's legal structure. Member States do not seem inclined to carry through such changes. Yet, if the proposed supervisory system fails in its tasks, the only real alternative to EU integration is increased national control. This would imply cutting back the single market and would, furthermore, lead to a less integrated financial sector, an unattractive prospect for policymakers.

In summary, while the supervisory reforms have been comprehensive, they have not gone so far as to solve the pre-crisis supervisory shortcomings. The reforms have rather equipped supervisors with a set of tools to address them. If these tools proof insufficient, swift reforms must not to be shied away from. It should not take another financial crisis before policymakers dare to take new far-reaching reforms.