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Panel on Banking and Financial Integration in Europe: the evolving rules

Governance and Structure of European Finance after EU enlargement. SUERF

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Let me begin by saying that I am delighted to share this forum with such distinguished speakers, and I look forward to having a good discussion about the evolving framework for the regulation and supervision of banks within the enlarged EU.

In my view, the Lamfalussy approach is the key to building an effective framework. In the present company, I would not presume to explain what the Lamfalussy approach is. But I would like to use my time today to make three main comments from my perspective as Chair of one of the committees that forms part of this approach within the banking sector – the Committee of European Banking Supervisors (CEBS). I hope that these comments will provide some food for thought on how we can ensure that we are making full use of the possibilities that the Lamfalussy approach offers us to build a common culture for regulation and supervision.

- Firstly, I believe that the Lamfalussy approach provides for a range of solutions, which means that it is possible both to be flexible and to develop over time;
- Secondly, in my view we should look carefully at the possibilities presented by level 2, in order to make sure that we exploit them properly;
- Thirdly, we must remember that the Lamfalussy approach is not just about good regulation, but also supervision. The so-called “level 3” of the Lamfalussy approach is a potent tool.

Let me begin with the first of these. I believe – and I hope that Baron Lamfalussy will agree with me - that we need to think of the Lamfalussy approach as a flexible approach. In an evolving environment, we cannot think in rigid terms. I do not believe that there are three mutually exclusive models of supervision for the EU: completely decentralised arrangements; a completely centralised approach; or the Lamfalussy approach. In my view, the Lamfalussy approach does not dictate a single solution to cover every eventuality, but rather it has a lot of flexibility built into it and provides for a range of different degrees of centralisation and commonality of approach according to the issues on the table. Furthermore, I believe that the Lamfalussy framework and the way it is applied can and should evolve over time, as the markets evolve themselves.

In other words, I think we can go a long way within the context of the framework. And I don't think we are anywhere near the stage where we can say that we are fully exploiting all of the possibilities it offers, at least in the banking sector.

Perhaps at this stage it is worth just recalling briefly what it is we are trying to achieve with the Lamfalussy approach: (1) regulation that can adapt quickly to new market developments and practices, support integration and enhance EU competitiveness; (2) strengthened cross-border and cross-sector co-operation amongst supervisory authorities and greater convergence of day-to-day supervisory practices and implementation.

In order to achieve these aims, it seems to me that we need: a strong level 1 framework of core principles that stands the test of time; strong level 2 regulation that ensures consistency and legal certainty, but that can be updated to respond to developments; and a strong level 3 that delivers consistency and convergence in application of the regulation agreed in levels 1 and 2, and also in areas which are not covered by EU law, whilst permitting the necessary degree of supervisory judgement.

So, what progress has been made in achieving these objectives in the banking field? It is rather early to make a profound assessment, in particular as regards the legislative/regulatory side (levels 1 and 2):

- Firstly, although CEBS as the Level 3 Committee was established a year ago, the Level 2 committee has not yet been formally established due to some technicalities which I understand will soon be resolved.
- Also, the only piece of EU banking legislation currently going through the legislative process – and it is one that will have a profound effect on banks and their supervision (Basel II) – is not a “true” Lamfalussy directive. The technical detail is already part of the proposal and will go through the full co-decision process, although it should be possible to update parts of this technical detail in the future through comitology.
- While there are good reasons for this approach, I hope we will see more use of the full level 2 approach in the future. Both so that CEBS can play its full and proper role in helping to develop future technical detail, as foreseen by the Lamfalussy report, but also in reviewing existing legislation to see whether some of it could be classified as level 2 or even level 3 measures.
- Indeed, personally I would be in favour of looking at the whole body of existing banking legislation and evaluating it in the light of the Lamfalussy approach. This is obviously a major task and requires case-by-case assessment, but it certainly seems a logical progression and could be very helpful for the industry.

But when we talk about flexibility and responsiveness, we should not simply think in terms of whether a regulation can be easily updated. We should think also about how it is applied in practice. We are always hearing arguments against having a “one-size-fits-all” approach, and against over-regulation. Indeed, over-regulation was named as a number one risk facing the global banking industry in a recent survey by the Centre for the Study of Financial Innovation.

The European banking industry is not sufficiently homogenous that we can apply one set of rules to cover all banks. Nor are the issues that the banks face so simple that we can cover every eventuality in regulation.

That is not to say that we should be inconsistent. But we need a balance between rules and discretion. In the end, supervision is about judgement, not mechanics. Pillar 2 of the new Basel II capital framework is a classic example. On the one hand, some parts of the industry have effectively asked for more codification of pillar 2, to provide greater certainty and a level playing field. On the other hand, they argue that they do not want automatic capital add-ons and stress that pillar 2 is about judgement. But more codification means more automaticity!

Naturally we work very closely with the industry to find the right answers. Dialogue, transparency and interaction are very important keywords when describing our cooperation with market participants. We also take very seriously our obligation and commitment to be accountable for our actions.

At the same time we also have to respect the subsidiarity principle. We should only do at centralised levels what should or could not be done at local levels. Supervisory tasks are best performed as close as possible to supervised entities, although an environment of increased cross-border and cross-sectoral activity requires arrangements to facilitate necessary convergence and information flows.

What we need is a framework which gives sufficient consistency of approach to ensure a level playing field, to avoid unnecessary supervisory burden, and to encourage banks to develop their risk management techniques. This is where level 3 convergence and co-operation comes in. And as the Chair of the level 3 Committee I am pleased to say that we have made a lot of progress in our first year in this area (which has, for the reasons I outlined earlier - been the main focus of our work).

During its first year of operation CEBS has:

- Published a Consultation Paper on its consultation practices;
- Published a Consultation Paper on Pillar 2;
- Published a Consultation Paper on outsourcing (which is a good example of level 3 work in an area not currently covered by EU regulation);
- Agreed a common reporting package for the solvency ratio.

Apart from this, we are about to publish papers on supervisory co-operation between home and host supervisory authorities, supervisory disclosure, financial reporting, and a new package on pillar 2 based on the responses we received from the industry to our first consultation paper. The first topic I mentioned – supervisory co-operation between home and host supervisors – is important to highlight, because level 3 is not just about convergence but also co-operation and information sharing.

Some people express doubts about whether level 3 convergence agreements can really be effective, given that they are not binding. While it is early for us to make a judgement in any of the sectors, I am optimistic.

- Firstly, level 3 is by its nature based on consensus – which means that all supervisors have agreed and signed up to it. This makes the chances of successful application higher;
- It is not “imposed” by an external body, but rather developed by the supervisors themselves – so there are less grounds for them to deviate from its contents;
- It provides detailed guidance which has been carefully constructed – and of course it is always easier to use and build on guidance that already exists rather than to develop new guidance;
- The very process of developing level 3 guidance brings together the views of members, and promotes cross-fertilisation of ideas;
- And, in any case, market discipline will play a major role – level 3 standards are developed with industry input and are public. Therefore, the industry/market will put pressure on the supervisors to adhere to them. I also expect that supervisory disclosure of approaches and implementation will be a powerful tool in applying peer group pressure on national authorities.

In concluding, I would reiterate my view that Level 3 is very important. It is about building a European supervisory culture. It is the *raison d’être* for CEBS, and we will be judged by our achievements in this area. So far, we have grounds to be optimistic. A body of level 3 guidance is emerging, which, combined with a strong level 1 and 2 measures, should deliver regulation and supervision fit for the 21st century EU banking sector. But this is a challenge, and we all need to play our part.

I would like to finish with a few words about the impact of EU enlargement on the regulatory and supervisory framework that I have been talking about. I know that there are concerns in some parts that enlargement will slow down the progress towards a truly single market in Europe. From CEBS’ perspective, however, I must say that I see the incorporation of the new countries as a great opportunity to build convergence. We are all embarking on a new approach to banking regulation and supervision with the advent of the Basel II framework, and we are all “learning by doing”. This makes it a very opportune time to have the new countries on board with us. Our experience so far has been positive - indeed, some of the initiatives that we are taking in CEBS have stemmed from suggestions made by the new countries. I think this positive experience can only continue in the future.