# Lamfalussy follow up - Future structure of supervision

2008/2148(INL) - 09/10/2008 - Text adopted by Parliament, single reading

The European Parliament adopted by 565 votes to 74 with 18 abstentions, a resolution containing recommendations to the Commission on the Lamfalussy follow-up: future structure of supervision. The resolution was drawn up under Rule 39 of Parliament's Rules of Procedure, whereby the EP can use its right formally to request that the Commission draw up legislation on a particular subject (Article 192 of the Treaty).

The own-initiative report had been tabled for consideration in plenary by Ieke van den **BURG** (PES, NL) and Daniel **DAIANU** (ALDE, RO) on behalf of the Committee on Economic and Monetary Affairs.

Financial supervision has not kept pace with market integration and the global evolution of financial markets. MEPs consider that existing regulation and supervision systems should be updated in order to tackle systemic risks better, provide financial stability, attain the objectives of the European Union and contribute to improved global financial governance.

Concerned about the current financial crisis, the report formally calls on the Commission to come up with significant proposals to improve the supervisory architecture for financial services in Europe.

Detailed recommendations on the content of the proposals are as follows:

**Recommendation 1 - Basic prerequisites for effective regulatory and supervisory arrangements**

1) Improve the EU financial services regulatory framework: the resolution suggests revising capital requirements rules by strengthening risk management, liquidity and exposure provisions in a consistent and, where appropriate, counter-cyclical manner for entities operating on financial markets. Capital requirements should be defined for complex financial products and derivatives.

**2) Measures to improve transparency**: MEPs call for measures to foster transparency, clarity and the provision of data on **complex financial products** and the securitisation process. They request an appropriate accounting treatment of material securitisation vehicles. They consider that credit rating agencies should use consistent and appropriate rating terminology that clarifies how such products differ among themselves especially in terms of volatility, complexity and vulnerability to market stress. They also call for an appropriate accounting treatment of material securitisation vehicles, so that companies and financial institutions cannot artificially keep material special purpose vehicles off their balance sheets. MEPs state that the rules on valuation and pricing standards for complex financial products should be appropriate, in particular in the context of international accounting standard IAS 39.

**3) Governance measures**: governance must also be improved. On **securitisation**, originators are required to assess and monitor risk and ensure transparency of the debt or mortgage backed securities in order to allow investors to perform adequate due diligence. In addition, financial institutions must disclose their **remuneration policy** (in particular the remuneration and compensation packages of directors). All transactions involving management should be clearly identified in the financial statements and prudential supervisors should include in their assessment of risk management the influence of remuneration, bonus schemes and taxation to ensure that they contain balanced incentives and do not encourage extreme risk taking.

MEPs also call for **liability regimes** to provide for appropriate fines and other penalties for failure to comply with financial services legislation.

Lastly, as regards **credit rating agencies**, MEPs call for measures addressing e.g. conflicts of interests, quality assurance systems and oversight in a manner consistent with the considered recommendations so as to enhance credit rating processes.

**Recommendation 2 - Financial stability and systemic risk measures**

The resolution calls for the creation of **databases, forward-looking scenarios**, policies on macro prudential supervision and financial stability, as well as an **early-warning system** and ensure that the European Central Bank (ECB), the European System of Central Banks (ESCB) and the Banking Supervisory Committee of the ESCB (BSC) take an active role in their initiation, elaboration and operation.

MEPs request **EU crisis prevention, management and resolution arrangements** at EU level, including: i) monitoring and assessing systemic financial risks at EU level; ii) setting up an EU early-warning system and early-intervention mechanism for dealing with weak and failing entities, when an EU cross-border financial group is concerned or when the EU financial stability is threatened; iii) facilitating the cross-border transfer of funds within a group in extreme situations and ensure cross-border crisis management and clarify State aid rules in cases of cross-border crisis; iv) (ii) enhancing crisis resolution arrangements by improving the EU rules on winding up and setting up arrangements of burden sharing among relevant Member States in cases of insolvency within cross-border financial groups.

The resolution calls for an urgent revision of EU rules on **deposit guarantees** so as to avoid arbitrage between guarantee levels in Member States that may further increase volatility and undermine financial stability instead of increasing security and depositors' confidence. The **level of refund** should be significantly increased and the availability of refunds to retail clients in case of failing financial institution should be ensured within a reasonable timeframe including in cases of cross-border situations.

**Recommendation 3 - Supervisory framework**

The resolution recommends:

1) the adoption, by the end of 2008, of a regulation which will require the setting up of **colleges of supervisors for the largest cross-border financial groups or holdings** operating in the EU. The colleges will be composed of representatives of the national supervisory authorities dealing with prudential supervision. The regulation should contain clear principles for the national supervisors that have to be represented in the mandatory colleges, taking into account the group’s market size in a Member State, the volume of cross-border operations, the volume and value of assets to reflect the importance of the group activities, ensuring that all Member States in which the parent undertaking, subsidiaries and significant branches are operating will be represented, and also taking into account the need to involve third-country supervisors where reasonable and practicable.

The colleges will normally be chaired by the consolidating supervisor from the Member State where the central administration or the main EU office of the cross-border financial groups or holdings is established. The colleges will decide, where appropriate, on the basis of a qualified majority voting (QMV) system based on principles and objectives that will ensure consistency, fair and appropriate treatment and a level playing field.

2) the adoption, by the end of 2008, of a regulation which will strengthen and clarify the **status and accountability of the Lamfalussy Level 3 Committees** (CESR for securities, CEIOPS for pensions and insurance, and CEBS for banking) giving them legal status commensurate with their duties. This

regulation shall coordinate and streamline the action of the different sector supervisory authorities, reinforce their tasks and ensure appropriate staffing and resources.

In addition to the advisory tasks, the Lamfalussy Level 3 Committees will be given the task to ensure and actively promote supervisory convergence and a level playing field in the implementation and enforcement of EU legislation. The Lamfalussy Level 3 Committees can take decisions on the basis of a fair and appropriate qualified majority voting system that takes into account the relative size of the financial sector and the GDP of each Member State, as well as the systemic importance of the financial sector for the Member State. Parliament, the Council and the Commission should approve the Committees' annual work plans and reports.

3) the presentation, by the end of 2008, of a proposal which will require **arrangements for financial stability oversight** at EU level. Those arrangements should ensure the efficient collection and analysis of micro and macro prudential information for the early identification of potential risks to financial stability, integrated with global work on financial stability. Those arrangements should enable EU supervisors and central banks to react promptly and develop a rapid reaction force for crisis situations with a systemic impact for the European Union.