Report of the European Banking Federation

Integration of European Financial Services Markets

Background paper by Prof. Christos Gortsos
Secretary General, Hellenic Bank Association

July 2007

TABLE OF CONTENTS

A. The process of financial integration

1. Definition of financial integration

2. Necessary and sufficient conditions for achieving financial integration

    2.1 Necessary conditions

    2.2 Sufficient conditions

3. Policy options for achieving financial integration

    3.1 Introductory remarks

    3.2 The question of competence

    3.3 The question of applicable law

B. European financial integration: the status quo

1. Introductory remarks

2. A categorisation of European financial law

3. The initiatives and policy options of the Community institutions

    3.1 Introductory remarks

    3.2 The period from the implementation of the Single European Act to the beginning of the economic and monetary union

    3.3 The creation of the monetary union

    3.4 The period after the beginning of the economic and monetary union

C. Rule-making in the context of European financial law

1. The basic provisions

2. The "Lamfalussy process"

D. The way ahead: towards pan-European financial supervisory authorities

1. Introductory remarks

2. The alternative options

    2.1 A single European financial supervisory authority

    2.2 Sectoral European financial supervisory authorities

    2.3 Common conditions for the creation of pan-european financial supervisory authorities

3. A specific issue: Possible future duties of the ECB in connection with the prudential supervision of financial firms

    3.1 Institutional grounding

    3.2 Conditions for the activation of the provision of para. 6 of Article 105 of the Treaty

    3.3 Financial firms concerned

A. The process of financial integration

1. Definition of financial integration

Taking as a starting point the view that national financial systems[1] have historically been segmented, financial integration is part of the currently heavily emerging process of financial internationalisation. Evidently, however, the process of financial integration aims at deeper results in comparison to that of financial internationalisation, because its ultimate purpose is the establishment and functioning of a single financial area within the context of a common economic area ("microeconomic integration"). It may be even deeper if the states concerned strive also at "macroeconomic integration", as it is the case in the European Community, which has already achieved its monetary unification.

Financial integration has been defined by the European Central Bank in the following terms: *"the ECB (…) considers the market for a given set of financial instruments or services to be fully integrated when all potential market participants in such a market (i) are subject to a single set rules when they decide to deal with those financial instruments or services, (ii) have equal access to this set of financial instruments or services, and (iii) are treated equally when they operate in the market"*. [2] It may be achieved by market forces ("market-led process of integration"), by self-regulation and/or by binding rules arising from inter-governmental or supranational institutions.

The result of financial integration is the creation of a single financial area among the participating states in which the following six (6) conditions are met:

(a) Ultimate savers (that is, the economic units which have an income for saving) who are domiciled or reside in one state have direct access to the financial services and the capital markets of the other states so that they are in a position to obtain the combination of risk – return most beneficial to themselves which is possible within the single area.

---

[1] Financial systems provide two basic functions:

- the channeling of funds from ultimate savers to ultimate borrowers, either through the money and capital markets or through financial intermediation (banks and insurance companies),
- the provision of payment instruments for those who do not want to use cash in their transactions.

Integral part of a financial system are its infrastructures, and notably:

- small-value and large-value payment systems,
- clearing and settlement systems for payments and financial instruments, and
- credit bureaus.

[2] See European Central Bank (2007): *Financial Integration in Europe*, March, European Central Bank, p. 5.

(b) Ultimate borrowers (that is, the economic units which need loan capital for the financing of productive investments and consumer needs) who are domiciled or reside in one state have free access to the capital markets and the financial firms of the other states to draw on funds (own or borrowed).

(c) Financial firms (indicatively, credit institutions, investment firms and insurance undertakings) with their statutory registered office in one state are free to provide their services without administrative restrictions to ultimate savers and borrowers who are domiciled or reside in other states, either through establishment (of branches) or on a cross-border basis.

(d) The economic agents who are domiciled or reside in one state and wish to conduct cross-border payments have the ability to do so under the same conditions prevailing for domestic payments.

(e) The undertakings providing payment instruments with their statutory registered office in one state may freely provide their services to users who are domiciled or reside in other states.

(f) There exists a functional interlinking between the infrastructures (i.e. payment, clearing and settlement systems) of the financial systems of the states involved in the process.

2. Necessary and sufficient conditions for achieving financial integration

2.1 Necessary conditions

The necessary conditions for the achievement of financial integration are two:

- the abolition of restrictions in the movement of capital, and
- the abolition of obstacles to the carrying out of cross-border financial transactions and the establishment of financial firms on the territory of other states (the process of "negative integration").

2.2 Sufficient conditions

In addition, the smooth functioning of a single financial area presupposes the adoption and implementation of policies (and, consequently, of rules) which will enable the satisfaction (as a minimum) of the following five (5) **"policy objectives"** (the process of "positive integration"), with simultaneous preservation of the existence of equal terms of competition ("competitive equality") between all categories of financial firms operating in the single area, if they provide services of the same nature and are exposed to similar risks:

- ensuring the stability of the financial system which may be imperilled by the occurrence of 'systemic crises', a requirement which can be further broken down into five individual, closely bound up, requirements:
  - ensuring the stability of the banking system;

- ensuring the stability of capital markets;
- ensuring the stability of the market for the provision of private insurance;
- ensuring the stability of the financial system (as a whole) in the presence of financial conglomerates;
- ensuring the smooth operation of the payment, clearing and settlement systems;

- ensuring the effectiveness of the capital markets;
- ensuring the effectiveness of the payment systems;
- ensuring the protection of consumers who engage in transactions with financial firms; and
- preventing and combating economic crime in the financial system.

3. Policy options for achieving financial integration

3.1 Introductory remarks

In an internationalised system, and especially within the context of a single financial area, in which financial firms incorporated in one state are operating through subsidiaries and/or branches established in states other than that in which their registered office is established, two basic questions arise, from a regulatory point of view, *in connection with the achievement of each and every of the above-mentioned policy objectives*:

- which authorities should be competent for the supervision, regulation, and/or oversight (as the case may be) of financial firms in general and in particular of their foreign establishments;[3]
- which law should govern the achievement of these objectives. [4]

[3] For example, in the case of banking system stability, the questions arise:

- which authorities should be responsible for the licensing and prudential supervision, the implementation of re-organisation measures and winding-up procedures, and the provision of last resort lending to the foreign branches and subsidiaries of a bank, and
- which deposit guarantee systems should cover the deposits of these foreign establishments.

[4] For example, in the case of banking system stability, the question arises with regard to the law that should govern the licensing and prudential supervision, the implementation of reorganisation measures and winding-up procedures, the deposit guarantee systems, and the lending of last resort with regard to the foreign establishments in question.

3.2 The question of competence

As to the *question of competence* there are three alternatives which can be applied:

(a) The first possibility is that there should be a supra-national institution to which the management of the above measures and policies has been attributed by the states involved.[5]

(b) The second possibility is for these competences to be attributed to the authorities or the systems, as the case may be, of the state in which the registered office of the parent enterprise is established, that is the home state (or state of origin), in implementation of:

- the principle of mutual recognition by all the states involved of the provisions which the others have adopted;
- the principle of consolidated supervision, in the case of prudential supervision of the foreign subsidiaries of the credit institutions.

(c) The third possibility is for these competences to be attributed to the authorities or systems, as the case may be, of the state in which the foreign branches or the foreign subsidiaries of the financial firms operate, that is, the host state.

1.3 The question of applicable law

The alternatives to the *question of the law applicable* are similar:

(a) The first possibility is for harmonised rules to be applied, which are issued from a supra-national institution. The harmonisation in question may be full, targeted or partial as to the scope of the issues covered,[6] and in both instances maximum or minimum as to its level.[7]

---

[5] As to the particular question of who should have the competence, at a national or supra-national level, for the exercise of prudential supervision over banks, the theory has been concerned with two basic issues:

- whether the monetary authority (that is, the central bank) should or should not exercise this competence,
- whether the supervisory authority, whether this is the central bank or an independent administrative authority, should have the competence only for the supervision of banks, or whether there should be a single supervisory authority for the entire financial sector.

[6] By "full" harmonisation is meant where it covers the whole of the aspects which touch upon a specific safeguarding policy (e.g., of prudential supervision), and by "limited"' when this condition is not fulfilled. "Targeted" harmonisation means limited harmonisation on specific pre-determined issues.

[7] "Maximum" harmonisation applies when there is no discretion for the adoption by a state involved of rules stricter than those which are covered by the field harmonised; "minimum" harmonisation applies where the above discretion is left to the states involved.

(b) The second possibility is for the rules of the home state to be applied, particularly where the authorities of the state in question are competent. Where harmonisation (if it exists) is not full and maximum, the rules of the state of origin may be applied on a complementary basis.

(c) The third possibility is for the rules of the host state to be applied, particularly when the authorities of the state in question are responsible for. Where harmonisation (if it exists) is not full and maximum, the rules of the state of origin may also be applied complementarily.

It is obvious that these questions must lead to specific regulatory options in relation with the above-mentioned policy objectives, and, in any event, the necessity for a different regulation in the case of foreign branches in relation with that followed in the case of foreign subsidiary (banking) enterprises should be respected.

Taxonomy on the harmonisation of rules				
		Scope of harmonisation		
		Full	**Targeted**	**Limited**
Level of harmonisation	**Maximum**	***(Total/absolute)***		
	Minimum			

Where, in relation to a policy objective, there is full and maximum harmonisation, this is termed "absolute" (or "total") harmonisation.

B. European financial integration: the status quo

1. Introductory remarks

The process of financial integration in the European Community has been forwarded during the last decade consistently. The main driving forces have definitively been the initiatives taken by Community institutions which have already delivered a substantial body of "European financial law". This remark is with no prejudice to the initiatives taken by market operators (notably in money and capital markets and especially after the introduction of the euro) as well as bold self-regulatory initiatives, such as the creation of the Single Euro Payments Area (SEPA).

European financial law is a branch of European economic law. It is defined as the totality of the provisions by means of which the achievement of the financial integration of the Community is sought by the creation of a single European financial area, as a discrete sub-unit of the single market. The provisions of European financial law introduce regulatory interventions in the operation of the financial system of the member states of the Community for the satisfaction of the above mentioned (under A 2 and A 3) policy objectives which are judged to be the necessary and sufficient conditions for the achievement of this integration.

European financial law has been shaped through secondary European banking law. The constituent parts of this architecture have been determined mainly by a series of Community Directives (since the use of Regulations has been very limited). This architecture is governed by the principles of:

- decentralised management of policies,
- mutual recognition of the regulatory provisions which have been adopted by the member states, and
- harmonisation at a Community level of certain provisions which concern management policies (but with significant differentiations as to the extent and level of the harmonisation).

On the other hand, European law does not contain any provisions in connection with last resort lending.

It should also be noted, for the sake of completeness, that apart from the relevant provisions of European financial law (in accordance with what is explained below), also applied to most categories of financial firms are provisions of a "horizontal character" of other branches of European law such as:

- commercial law (e.g., company law and law on competition),
- taxation law,
- general consumer protection law, as well as
- labour and social law.

2. A categorisation of European financial law

On the basis of the policy objectives, the satisfaction of which is sought by the issuing of related legislation, the provisions of European financial law can be categorised under eight individual branches.

(a) The first branch of European financial law is **European banking law**, which contains provisions by means of which the following objectives are sought:

- the ensuring of free establishment and provision of services by credit institutions (a term of Community law which is used instead of the term 'bank') and financial institutions (e.g. leasing, factoring, card companies);
- the safeguarding of the stability of the banking system from the possibility of the occurrence of chain bankruptcy of credit institutions.

(b) The second branch is **European capital market law**, which contains provisions by means of which the following objectives are sought:

- the ensuring of free establishment and provision of services by undertakings which provide investment services, on an individual or collective basis;
- the ensuring of the stability of the capital market, which may be disrupted chiefly by reason of the bankruptcy of a financial institution which provides investment services to it;
- the ensuring of the effectiveness of the capital market, that is, both of the optimal allocation of funds which are drawn upon in them and of the protection of investors who wish to carry out or carry out investments in securities and financial derivative instruments traded on them.

(c) The third branch is **European insurance law**, which contains provisions by means of which the following objectives are sought:

- the ensuring of free establishment and provision of services by insurance undertakings;
- the safeguarding of the stability of the markets for the provision of private insurance from the possibility of the bankruptcy of undertakings which provide insurance and re-insurance services.

(d) The fourth branch is the **European law of supplementary supervision of financial conglomerates**, which contains provisions by means of which the safeguarding of the stability of the financial system (as a whole) from the possibility of the occurrence of generalised financial crises in the economy which are due to the undertaking of excessive risks by the so-called "financial conglomerates", in whose composition credit institutions, insurance undertakings and investment firms participate, is sought.[8]

---

[8] The supervision which is exercised over these groups, by which it is sought to limit the exposure of the undertakings which participate in their composition to risks because of their participation in a financial conglomerate, is of a supplementary nature, that is to say it

(e) The fifth branch is the **European law of payment systems**, which contains provisions by means of which the following objectives are sought:

- the ensuring of the smooth operation of the national payment and settlement systems, in view of the possibility of the occurrence of the risk of the transmission of problems of liquidity and/or solvency from one member of the system to other members, with all the systemic effects which something of this kind can entail;
- the ensuring of the effectiveness of the payment systems.

(f) The sixth branch is the **European law on the protection of consumers of financial services**, which contains provisions by means of which the ensuring of the protection of consumers who engage in transactions with financial firms is sought, with the aim of reducing the asymmetry of information which exists between providers and consumers, and dealing with the problem of the reduced negotiating capability of the consumer. In also contains provisions by means of which the prevention of the overindebtedness of consumers, particularly as concerns the provision of credit to consumers, is sought.

(g) The seventh branch is the **European law on the prevention and combating of economic crime in the financial system**, which contains provisions by which the prevention of the use of the financial system for the commission of economic crimes (such as, chiefly, money laundering) and the suppression of the crimes in question are sought.

(h) Finally, the eighth branch is **special accounting law for credit institutions**, which contains special provisions (as compared with the general provisions of European accounting law) on the financial reporting of credit institutions due to the special nature of their business.[9]

3. The initiatives and policy options of the Community institutions

3.1 Introductory remarks

In order for the requirement of the progressive abolition of the restrictions on freedom of establishment and freedom of provision of services to be fulfilled, the Council had to issue, according to the Treaty, and did in fact issue, in 1961, two General Programmes: the first concerned the abolition of restrictions in connection with freedom of establishment and the second the abolition of restrictions in connection with freedom of provision of services by the end of 1969. As to credit institutions and the other categories of financial firms, the programmes required the following:

---

is exercised in addition to the supervision of the separate undertakings on an individual basis, and on a consolidated basis at the level of conglomerates.

[9] After the adoption of the International Accounting Standards these provisions apply only to non-listed credit institutions (unless a member state has decided to impose these standards also on them).

- abolition of the restrictions in connection with freedom of establishment and freedom of provision of services which are not connected with the movement of capital;
- abolition of the restrictions in connection with banking services which are connected with the movement of capital to the same degree as the removal of restrictions on the movement of capital.

However, the above General Programmes proved ineffective as to the abolition of the restrictions in the banking sector and in the financial sector in general and, consequently, their contribution to the shaping of the single European financial area is negligible.

3.2 The period from the implementation of the Single European Act to the beginning of the economic and monetary union

The substantive boost to the progress towards the creation of the single financial area was given after the issuing of the Single European Act. The related Community acts were issued in two stages:

(a) The first stage covered the period 1988 – 1992, during the course of which the programme of the European Commission on the single market was realised by the issuing by the Council of the basic Directives by means of which the foundations for the single financial area were laid down. The objectives of the legal acts of secondary Community law which were issued in this period were:

- the ensuring of freedom of establishment and cross-border provision of services within the Community of the various categories of financial firms (e.g., credit institutions, investment services undertakings, UCITS, and insurance undertakings);
- the ensuring of the stability of the single banking market;
- the ensuring of the stability and effectiveness of the single capital market;
- the ensuring of the stability of the single insurance market;
- the protection of consumers of financial services;
- the prevention and, above all, combating of the use of the financial system for the commission of economic crimes.

In order to achieve the above aims, use was made of three basic principles of international law: the principle of mutual recognition - by all member states - of the national legislative and regulatory provisions of the rest, and the principles of the minimum and partial harmonisation at Community level of certain basic rules to make possible an approximation of national legislations. Also substantive was the option:

- that European supervisory authorities should not be set up in the three discrete (though increasingly interconnected) areas of the financial system (banking, capital market, insurance);[10]
- nor that there should be unification of the infrastructures of national financial systems.

(b) This was followed by the period 1993 - 1998, during which further reinforcement of the Community regulatory framework was pursued, either by the adoption of new Community acts or through amendments improving provisions of the existing acts.

3.3 The creation of the monetary union

The role of the European System of Central Banks (the “ESCB”) in connection with the stability of the European banking system is delineated by the provisions of para. 5 of Article 105 of the Treaty, according to which "*The ESCB shall 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.*" From a reading of this provision, which is repeated verbatim in Article 3.3 of the Statutes of the ESCB,[11] two basic conclusions can be drawn:

(a) To begin with, neither the ESCB nor the European Central Bank (the “ECB”) has been elevated to the status of a 'competent authority' within the meaning given to this term by secondary European banking law, (in accordance with what has been stated above). Consequently, the granting of a licence, the exercise of prudential supervision, and the carrying out of controls to ascertain the compliance of Community credit institutions with the provisions of the related regulatory framework continue after the beginning of the third stage of EMU to fall within the competence of the appropriate authorities of the member-states, whether these are national central banks - members of the ESCB - or independent administrative authorities. This does not conflict with the provision of the first sub-paragraph of article 14.4 of the Statutes, according to which national central banks can perform functions other than those which are determined in the Statutes, unless the Board of the ECB decides, by a majority of two-thirds of the votes, that these functions impede the aims and duties of the ESCB.

(b) The duty of the ESCB is limited to 'contributing' to the smooth exercise of policies by national competent authorities which concern the prudential supervision of credit institutions and the stability of the financial system. The means for the realisation of this contribution are not determined in the provision in question but result from a reading of other articles of the Treaty and the Statutes.[12]

---

[10] It is instructive that not even the single monetary authority, the European Central Bank, has been elevated into a European supervisory agency. See analytically below, under 3.3.

[11] The provisions in question are not applied in the member states with derogation or in the United Kingdom.

[12] The main means which the ESCB has at its disposal emerges from the implementation of the provision of Article 25.1 of the Statutes of the ESCB. The contribution of the ECB

Hence, the implementation of the provisions of the Treaty on monetary union has not affected the constituents of the architecture currently in force in accordance with European banking law which governs the safeguarding of the stability of the European banking system. The basic principles which govern this architecture, and *par excellence* the principle of decentralised management of policies, have not been altered, since the ESCB has not acquired the capacity of a single supervisory authority in the euro-area analogous to that which it has in the monetary field, nor has it been granted relevant regulatory competences.

The competence of the ESCB is limited to a role of contributing to the smooth exercise, on the part of the national competent authorities, of prudential supervision of credit institutions and the stability of the financial system. An alteration would occur only if the provision of para. 6 of Article 105 of the Treaty were brought into effect and the ECB were elevated into a single supervisory authority in the euro-area.[13]

3.4 The period after the beginning of the economic and monetary union

The adoption of the single currency, on 1 January 1999, served as a catalyst in expediting the procedures which tend towards European financial integration. Within this framework, two important initiatives were taken by the European Commission:

(a) To begin with, in 1999 it issued a White Paper in connection with the implementation of a framework for action on financial services in which were set down the actions to be undertaken at a Community level so that by 2005 the regulatory framework which governs the operation of the single financial area would be completed. The strategic aims of this Financial Services Action Plan (FSAP) were four in number:

- the enhancement of the existing regime of prudential supervision of financial firms and of the groups in which these participate;
- the shaping of open and safe markets for low-value transactions;
- the integration of the single European capital market;
- the satisfaction of certain broader conditions which must govern the operation of the single financial area, such as, chiefly, taxation harmonisation.

---

may also be realised by the collection of statistics in accordance with the provisions of Article 5 of the Statutes, as well as by its participation (and/or the participation of the national central banks – members of the ESCB) in international organisations and *fora.*

[13] On this, see below under D.

The FSAP functioned within a framework of principles which had already taken shape (mutual recognition, minimum and partial harmonisation) for the achievement of the above policy objectives in the financial sector, but it clearly drew attention to a new one: the requirement for the creation of a single area for low-value payments, corresponding to the unified pan-European system of high-value payments, the TARGET system, which was brought into operation in 1999 as a support mechanism for the exercise of the single monetary policy of the European Central Bank. Furthermore, for the first time the prospect of taxation harmonisation in the financial sector began to be substantively discussed.[14]

The FSAP was in fact completed in 2005, given that of the 42 measures which had been provided for, 41 have already been adopted. The measures taken concern a host of issues, such as:

- markets for financial instruments;
- prospectuses;
- the obligations of transparency which must be observed by issuers whose securities are admitted to trading on a regulated market;
- undertakings for collective investment in transferable securities;
- the International Accounting Standards;
- take-over bids;
- distance marketing of consumer financial services;
- insurance mediation; and
- winding-up and reorganisation of credit institutions.

[14] It was within this framework that **Directive 2003/48/EC** of the Council on the taxation of revenues from savings in the form of interest was issued, the aim of which was the actual taxation of payments of interest in the member state where the actual beneficiary (a natural person) has his domicile for tax purposes, in accordance with the national legislation of that state.

C. Rule-making in the context of European financial law

1. The basic provisions

During the past decade, and notably following introduction of the euro as the single European currency, the volume of the European financial law, namely the totality of provisions of primary and (mainly) secondary European law, adopted to achieve the maximum possible European financial integration within the operation of the single market in the European Community, has increased exponentially. As a result of this development, a convergence was achieved, to a large extent (compared to how things stood even at the end of the 1990's), in the content of member states' legislative, regulatory and administrative provisions pertaining to fields covered by the European financial law.

Albeit the European financial law evolves independently, based on political initiatives undertaken by Community institutions (European Commission, European Parliament and Council), and the opinion-giving influence of the European Central Bank, it is, however, greatly - and in some fields, decisively - influenced by the international financial law that takes its form within the context of the operation of numerous international organisations, and international *fora*, in particular, with the participation of national supervisory/regulatory authorities.

The legal acts issued based on various provisions of the Treaty establishing the European Community (hereinafter referred to as the "Treaty"), cover a very broad spectrum of issues, seeking to satisfy various policy requests concerning both the abolition of barriers in the provision of financial services within the Community (the field of negative integration), and single policy-shaping (the field of "positive integration").

In view of the confirmed political will to strengthen and deepen European financial integration, with the continuous expansion of the European financial law field of application, a question reasonably arises concerning the form of the "European financial rule". The critical latent question is not whether general or detailed regulations are required. In principle, European legislators, under the current conditions, must cover both levels, since should they focus on just general regulations, leaving specialisation to the member states, then the margin for regulatory arbitrage[15] would be significant, thus undermining the end goal which, as mentioned above, is the achievement of the maximum possible financial integration. Moreover, exercising regulatory intervention based on general principles and provisions, offers national legislators wide room for discretion, resulting in the establishment of diverse rules in the various member states, or the creation of uncertainty of law in case of non-specialisation of general principles.

[15] "Regulatory arbitrage" is the incentive for financial institutions to set up in states with the most lax regulatory (including tax) framework.

On the contrary, the critical question is the level to which detailed regulations shall be adopted, all the more so since the applicable institutional framework offers alternatives. In particular, according to article 202 of the Treaty, the Council may authorise the European Commission to adopt implementing measures ensuring the specialisation of and (conditional) amendment to the rules adopted - in the case of the European financial law, without exception - through the co-decision procedure between the European Parliament and the Council. Exercise of said implementing powers conferred on the European Commission, shall, certainly, be subject to the requirements set by the Council, whose content is directly affected by the European Parliament's interventions, aimed at ensuring the best possible institutional balance among Community institutions.

2. The "Lamfalussy process"

Until early 2000, the Council had made limited use of its discretion to confer implementing powers on the European Commission. Moreover, taking also into account the need to manage the constantly growing volume of legislative material to be adopted, thus enabling the deepening of the European financial integration - indeed in view of the provisions' more and more technical nature -, the Council activated the conditions for establishing a special procedure facilitating the process of conferring implementing powers on the European Commission. This framework led to the "Lamfalussy process", which does not constitute a total novelty in the process of issuing legal acts within the European financial law, but contains proposals making it easier for the Council to take up initiatives, along with the European Parliament, so that detailed regulation adoption increasingly become the competence of the European Commission, under the increased involvement of national supervisory/regulatory authorities within CEBS, CESR and CEIOPS, which were created according to the Lamfalussy proposals.

At the same time, enhancement of the collaboration among the member states' supervisory/regulatory authorities in the financial sector was institutionally established, albeit - contrary to what applies to the monetary policy - the administrative organisation of the European financial sector's supervision is still governed by the principle of decentralisation.

Some concluding remarks:

(a) Both the Treaty and the secondary law that has been generated with the relevant Council Decisions, have set the foundation, according to which a distinction is possible between general and detailed regulations in the European financial law; the European Parliament and the Council shall exclusively undertake the former category, while the European Commission shall undertake the latter, on the basis of an explicit authorisation.

(b) The procedure proposed by the Lamfalussy Committee, and adopted by the Community institutions, has established, based absolutely on the regulatory comitology procedure, mechanisms facilitating the Council in taking decisions for conferring on the European Commission implementing powers on the specialisation of general regulations adopted in the basic legal acts issued by co-decision.

(c) In this context, a major role is played by the committees that were established (CEBS, CESR, CEIOPS) made up of the national authorities in charge of supervising various categories of financial firms operating in the Community (credit and financial institutions, investment undertakings, UCITS, insurance and reinsurance companies, occupational pension funds), that have been assigned with important duties (both at level 2, and mainly at level 3 of the "Lamfalussy process").[16]

(d) The European Parliament constantly contends for and ensures more and more powers in the process regarding conferring implementing powers on the European Commission, which leads to the conclusion that in the next Treaty review, it will continue pushing to claim an equal position with the Council. Consequently, provided that the decentralisation principle with regard to the administrative organisation of the supervision of financial firms continues to apply, in the years to come, the debate will focus on the redistribution of powers between the European Parliament and the Council.

[16] It is worth mentioning that the "Lamfalussy process" does not apply neither to the rules of European consumer protection law nor to those of European law on the prevention and combating of economic crime in the financial system.

D. The way ahead: towards pan-European financial supervisory authorities

1. Introductory remarks

Under the current conditions prevailing in the European financial sector and the deepening of financial integration achieved so far, the time may anymore be ripe for the creation of supra-national supervisory authorities in the European financial system, either sectoral or one single authority for the entire financial system (excluding payment systems). Such a development, the implementation of which would undoubtedly necessitate the amendment of the Treaty, will alter the currently applicable institutional balance (as was the case in the European financial law with the establishment of the European System of Central Banks), and reiterate the question of who will be responsible of adopting both general and detailed rules in the realm of European financial law.

2. The alternative options

2.1 A single European financial supervisory authority

The first option is to create one single European financial supervisory authority, which will be responsible for the supervision and regulation of credit and financial institutions, investment firms and capital markets, as well as insurance companies and occupational pension funds. This option is relevant with the recent trend in several member states of the European Community which are abstaining from the "fragmentation principle" and resort to single authorities for the entire financial sector (excluding payment systems). According to the analysis provided below (under 3), the European Central Bank cannot be eligible for that role, unless article 105. par. 6, of the Treaty were to be modified, since according to this provision it may not become responsible to the supervision of insurance undertakings.

2.2 Sectoral European financial supervisory authorities

The second option refers to the creation of one or several (up to three) "sectoral" supra-national financial supervisory authorities. Given the existing institutional framework after the implementation of the "Lamfalussy proposals", one can easily consider that the CEBS, CESR and CEIOPS could be transformed from "consultative committees" in the course of Level 2 and Level 3 of the "Lamfalussy process" into pan-european authorities. Alternatively (even though least probably), the European Central Bank could become a sectoral pan-european supervisory authority for banking and/or capital markets, but not – as already mentioned – for insurance undertakings.

2.3 Common conditions for the creation of pan-european financial supervisory authorities

In both cases, there are four (4) issues arising with regard to the effective implementation of the initiatives to be taken in this respect:

(a) The first issue relates to the extent of the modifications that need to be made to the Treaty establishing the European Community in order for the pan-european financial supervisory authorities to be created.[17] These modifications refer to the following:

- the deviation from the principles of minimum and limited (or even targeted) harmonisation of rules, which is based on the subsidiarity principle, which is embedded in the Treaty;[18]
- the modification of the rule-making process for the financial sector at the European level, which is necessary if the pan-european financial supervisory authorities were to obtain the right to issue legal acts on the field of their competence (to become also regulatory authorities), in accordance with what was established for the European Central Bank in the field of monetary policy (according to article 110 of the Treaty);
- the introduction of provisions which will empower these pan-european financial supervisory authorities to supervise financial firms and impose on them sanctions in case of infringements, also in accordance with what was established for the European Central Bank (according to Regulation 2532/98 of the Council).

Additional safeguarding provisions will need to be initiated with regard to the independence and accountability of the pan-european financial supervisory authorities vis-à-vis national governmental authorities and European institutions.

(b) The second issue relates to the scope of financial firms and markets which will be under the supervision of the pan-european financial supervisory authorities. The discussion on this is centered around the determination of the criteria according to which there will be a categorisation between:

- "systemically important" financial firms and markets at the European level, which are expected to be the ones for which the creation of pan-european financial supervisory authorities seems to be imperative:
- the remaining European financvial firms and markets which will continue to be under the supervision and regulation of national authorities.

---

[17] Modifications will not be deemed necessary, if the European Central Bank were to assume supervisory and regulatory functions in the financial sector, subject to the abovementioned restrictions.

[18] See Protocol 30, par. 6, annexed to the Treaty.

(c) The third issue refers to the structure of the pan-european financial supervisory authorities and in particular whether these should have a federal structure, similar to the structure of the European System of Central Banks, or not. In the first case one can think:

- either of a "European System of Financial Sector Supervisory Authorities", or
- of (up to) three sectoral pan-european authorities:
  - "European System of Banking Supervisory Authorities",
  - "European System of Capital Markets Supervisory/Regulatory Authorities", and
  - "European System of Insurance and Occupational Pension Funds Supervisory Authorities"

(d) Finally, the fourth issue, which is relevant mainly for the banking sector, refers to the arrangements that will have to be made with regard to deposit guarantee schemes, winding-up and reorganisation measures and last resort lending facilities. In particular, the question arises whether, if the authorisation and prudential supervision of European credit institutions (or the "systemically important" among them) were to be assigned to supra-national financial supervisory authorities, the case might be in place to create also supra-national winding-up and reorganisation procedures for the credit institutions concerned and supra-national deposit guarantee schemes. If this proves to be impossible, alternatively one can consider the total harmonisation of the relevant rules at a European level.

Similar considerations have also to be made with regard to investor compensation schemes for investment firms, to the extent that these will subject to the supervision of supra-national financial supervisory authorities.

In addition, it has also to be determined, at least in terms of principle, that the lender of last resort for the credit institutions that will be under the supervisory powers of the supra-national financial supervisory authorities will be solely the European Central Bank in close cooperation with these authorities (which will be the only responsible for assessing whether the credit institutions concerned remain solvent – hence deserve last resort liquidity injunctions – and are only facing liquidity problems).

3. A specific issue: potential future duties of the ECB in connection with the prudential supervision of financial firms

3.1 Institutional grounding

It is laid down in para. 6 of Article 105 of the Treaty that "*The Council may, acting unanimously on a proposal from the Commission and after consulting the ECB and after receiving the assent of the European Parliament, confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings*". By the provision in question, which is repeated verbatim in Article 25.2

of the Statute, the possibility of elevating the ECB in the future into the role of a single European supervisory authority, analogous to its function as a single monetary authority is established. The "specific tasks" of the ECB could include the power of issuing operating licences to the financial firms referred to, the power of exercising prudential supervision over these agencies, and the competence of monitoring their compliance with the provisions of the regulatory framework.

3.2 Conditions for the activation of the provision of para. 6 of Article 105 of the Treaty

For the granting to the ECB of the power to perform this functional role, no amendment of the Treaty is required, but neither is an ordinary decision of the Ecofin Council sufficient. A formal condition is the taking of a unanimous decision by the Council, in the form of a Regulation, which must be preceded by the taking up of a position on the matter by more than one Community institutions. In particular:

- the Commission, which must submit a proposal in this connection;
- the ECB, the Board of which must give an opinion within the framework of consultations with the Ecofin Council;
- the European Parliament, which must also give its consent.

3.3 Financial firms concerned

If the provision of para. 6 of Article 105 of the Treaty is brought into effect, the ECB may be entrusted with the above functional role in relation to the prudential supervision not only of credit institutions but also of other financial firms. The concept of a "financial institution" is not defined either in the Treaty or in the Statute. However, from the wording of the provision ("*credit institutions and other financial institutions*"), there are good grounds for arguing that this concept is not confined to the content which it has in Directive 2006/48/EC or in other sources of secondary law, but that the whole of the Community financial firms fall within it, including enterprises which provide investment services in money and capital markets.

However, the exception of insurance undertakings is explicit. Consequently, even if the provision in question is brought into effect (which, of course, is difficult because of the unanimity which is required in the Council), the ECB would not be able to be elevated into a single supervisory authority for financial conglomerates, which is at odds with the current trend observable in many states all over the world.