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Enhancing supervisory convergence through CESR

Arthur Docters van Leeuwen

Chairman of CESR

Dear colleagues and participants,

First in my opening remark, I would like to take this opportunity to thank the BBA in the person of Ian Mullen for hosting this timely conference about such an important subject and to express my gratitude for this kind invitation.

I am sure you are all aware of the fact that CESR recently published an analytical paper “Which supervisory tools for the EU securities markets?” developed during the past six months by a Task Force of eight CESR-members which I had the honour to chair. There is a saying (that) “it is hard to forecast the future if you are not aware of the past”. With this in mind, I will re-fresh your memory and place the subject of supervisory convergence in a short historical perspective by refreshing our (collective) memory with a few of the key European milestones that we have passed along the way, before I go on to share with you some insights about our report.

HISTORY

At the turn of this century, discussion about supervision of financial markets in the EU concentrated on the (erroneous) idea that every supervisory problem could be solved, if only a single European regulator for banks, insurance companies and securities would be created. Many of us disagreed with this idea at a time, which came just as securities regulators were intensifying (informal) co-operation under the umbrella of FESCO. This was also during the period that the Financial Services Action Plan came into being. In the first years of existence of the FSAP at the end of the nineties, progress in the adoption of this legislative agenda was (too) slow. A Committee of Wise Men, chaired by the Belgian Baron Lamfalussy, was mandated by the EU-institutions to make proposals for improving the EU decision-making process and - in his own words - to find a solution for “the remarkable cocktail of Kafkaesque inefficiency”.

THE BIRTH OF CESR

The major outcome of the Lamfalussy-committee was twofold:



- (1) The introduction of the famous four-levels approach with its guiding principles, introducing: Framework Directives (level 1), implementing measures (level 2), improved cooperation (level 3) and intensified enforcement (level 4) which I will not develop here;
- (2) The establishment of the ESC and CESR, based upon the Stockholm-resolution, the decision of the European Commission and the resolution by the European Parliament which as you may recall identified the CESR network as best qualified to play this role of official advisor to the Commission because we (as individual regulators) were (and continue to be) responsible for the proper execution of any regulatory measures adopted. In previous speeches I have referred to this as the 'boomerang-effect'.

At present, I am proud to say that CESR has been fully accepted by the EU-institutions, has met with wide appreciation from various highly respected independent sources (such as the Inter-Institutional Monitoring Group) for our work done and, more importantly, is identified as serving very effectively the purposes for which it was established. Indeed, since then, CESR has operated as a role-model for similar arrangements to be introduced at EU-level in the areas of banking and insurance (CEBS and CEIOPS).

On substance (without undervaluing all of CESR's other activities), perhaps the most notable of our achievements has been in the areas of Market Abuse and Prospectus. On process, I believe we have given a new impetus in the EU, to the meaning of the word "transparency", as reflected in our consultation practices, assisted by our website as an efficient tool for distribution of information.

All this considered; we members of CESR have been eager beavers. We did so because we all share the conviction that our goal should be the creation of securities markets that are as deep and liquid as possible. Given the fierceness of global competition, attracting capital, even for the bigger national markets this is a challenge. The political wish to create a single European financial market coincided very much with our anxiety. So we have risen to the occasion and we will do everything within our means to deliver the best results we can by fully utilising this window of opportunity (afforded by the legislative initiatives introduced by the Action Plan as well as those delivered by the Lamfalussy process).

THE FUTURE OF CESR

Now that the 42 of these modernising legislative measures introduced by the Financial Services Action Plan (i.e. 95% of the initiatives initially proposed), are in the bag, the question is: how are we going to make it work? How should the European focus move from legislation to supervision and enforcement? Naturally therefore it is hardly surprising that in the European corridors of powers (and there are quite a lot of European corridors), discussions started regarding our role. For a seasoned campaigner it was not surprising to find out that these discussions were about us but did not include us. That accelerated consensus between the members of CESR. We did not like to be 'kicked', or perhaps I should say, 'shot', not to mix my metaphors, around the European pool table like a billiard ball (I am exaggerating). But basically, we wanted to be one of the billiard players active in the game. To respond to this, CESR created a smaller group of Chairmen who needed high-level staff assistants to help develop solid research and cover some serious 'ground'. In our vocabulary, we called them "sherpa's" and that is how the report got its nickname as the "Himalaya-Report".

THE HIMALAYA REPORT

Our consultative report is a first attempt for CESR to define how securities regulators can play their role in order to ensure full and consistent implementation as well as effective enforcement of all measures included in the Financial Services Action Plan in the area of securities in the next five years. Effective enforcement requires each supervisor to have a full "tool box" at his disposal. The most important objective of the report is therefore to identify and analyse the supervisory tools necessary to implement the FSAP in order to ensure they will be effective and capable of to meeting future demands. An advanced and sophisticated toolbox is needed because the developments of market segments towards integration are taking place at different speeds. For this reason the strategy we should adopt should be adaptive to the needs of the markets and incidentally this is also the reason why the idea of single super European regulator is flawed.

Our report concentrates on the objective of securities regulators which are to maintain fair, transparent and secure securities markets; it does not cover prudential issues related to the consolidated supervision of banks or insurance companies which are fundamentally of a different nature and focus. Neither does our analysis focus on law and rulemaking matters (for which the Lamfalussy-approach already provides a satisfactory response), but concentrates on the supervisory and enforcement decisions by securities regulators when applying the FSAP Directives.

The first part of the report takes stock of the current state of integration of EU securities markets. Our analysis has confirmed the view that the integration of the securities markets in the EU varies significantly according to the sectors and the categories of market players considered. We expect that less integrated and more integrated segments of securities markets will co-exist on a long term basis.

The second part of the report identifies three areas for improvements in response to the question “how to further convergence of policy, supervision and enforcement?”. These areas include:

- home/host relationships;
- the network of securities regulators;
- Trans nationality as an option for multi-jurisdictional cases.

I will deal with these areas in this order.

Home/host relationships

The FSAP directives impose additional and stronger obligations on the securities regulators to cooperate with each other than we have today. Various multi-jurisdictional business cases (Euronext, Nordea) illustrate the need for intensified cooperation between regulators and I have no doubt that more cases will emerge as the Single Market will continue to develop. It is CESR's view that these developments require all European securities regulators to have the same capacity (in terms of powers and financial resources) to act and should ideally include equivalent intensity in the usage of these powers in order to maintain a level-playing-field. The existence of equivalent and rigorous powers for supervisors to regulate, supervise, investigate, sanction and exchange information regarding investment services, issuers, auditors, regulated markets and UCITS, will benefit any home/host relationship or network arrangement and will advance the efficiency of supervision. The report envisages several additional supervisory tools that could be rapidly adopted. For example, the planning and conducting of joint inspections and closer consultation among involved regulators for decisions affecting multi-jurisdictional entities.

The network of securities regulators

The past three years have illustrated that the operations of a network arrangement can be effective and efficient. However, a network arrangement such as the one we have, does have - due to its nature - its limits. Let me list two of these. First of all, at level 3 we operate on the basis of voluntary participation and rely on the morally binding nature of the commitment by members to the network. Of course, our efforts illustrate that we can achieve a lot on this basis. Everybody wants us to do more! A very recent Financial Services Committee report qualifies our level 3 work as crucial, but its basis is no more (and no less) than voluntary participation and moral persuasion.

The second limit that now appears is of political nature. Some national Parliaments complain and similar complaints emerge in European Parliament as well, that CESR as far as the level 3 network activities are concerned, is not accountable. To be frank, there is truth in this argument. Although we formally are accountable to our national political masters, such a master cannot easily intervene if the other twenty-four members agree. Nor, is there a formal link of accountability to the European institutions either, as level 3 is about coordination of national activities. The conclusion must be that, yes the network activities should expand, but in synchronicity with enhanced European institutional accountability. There is now some urgency to this question, given that we now have our colleague level 3 committees (CEBS and CEIOPS), which are being constituted. This could triplicate the problem.

Trans nationality

In the report we recognize three possible areas for trans-nationality:



- The first area is delegation of powers or responsibilities from one national regulator to another. At present, Europe's legislation for securities markets makes this possible only in the limited area of approving Prospectus for issuers. So, why not consider this option in other fields as well? It could for instance be helpful in situations where crisis-management is needed. To give you one example, LCH/Clearnet is now regulated by no less than sixteen regulators on the basis of an MoU. This works well, but let us assume - God forbid - that something will get wrong with this beautiful machinery and would really create disfunctioning of the markets. Are we then going to set-up a crisis-management committee, consisting of sixteen members?
- The second area is in adopting pan-European decisions. I will limit myself here and will only give you two examples. As you know, credit rating agencies work on a global basis. If we are going to create permits for these entities - because ratings will be used in the execution of Basel II - who is going to authorise these permits? Was the passport system developed appropriate for situations such as these? I think it is - to say the least - doubtful. A second example is about IFRS. CESR-members have agreed that we will not decide nationally about IFRS without consulting the common database, or - if nothing is there yet - to consult each other. This will over time result in 25 coordinated decisions, but will this be enough to sustain one European financial reporting system?
- The third area for trans nationality can be summarized in a simple question: can a mediation mechanism be credible if it rests only on a pure voluntary basis?

It is CESR's view that all the potential tools under the legal framework of the FSAP should be explored before envisaging these far reaching approaches. As such, we have proposed five tests (or principles) which should be given due regard before the need for a EU wide single decision is triggered. These principles are briefly: efficiency, subsidiarity, balance, integration and uniformity. In other words, the ideas concerning trans nationality should only be implemented if it has been evidence-based demonstrated that the present system cannot be developed to provide proper solutions to the questions of supervisory convergence. Even if the outcome of one of the tests is found to be negative, it is clear that a decision with a trans-national dimension is drawing closer than it was four years ago when the Committee of Wise Men, chaired by Baron Lamfalussy, was set up.

WIDER CONTEXT

Before concluding my remarks, let us step back for a minute and not forget that EU financial markets are an integral part of the global financial markets. You all know that we, members of CESR, are optimists and that I am the first optimist among equals. But let us be pessimistic for five seconds. Let us assume that you, the industry, are not enterprising enough and that we, the regulators, are not adaptive enough to really create a working European Financial Market. How then are we going to cope with our US-colleagues who already have such an integrated market as home-market available? In a recent meeting with Senator Shelby I have sensed a positive attitude at Capitol Hill about the Transatlantic Dialogue that CESR is currently having with our SEC-colleagues. In order to stand firm in this Dialogue, the creation of an EU Single Market should be implemented forcefully. Since our system for supervision and enforcement is not stable yet, we should not rest our case and not hold on to the status quo, accepting a sub-optimal situation. To meet the goal of a Single Market in Financial Services (as far as securities markets are concerned), CESR sticks to its practical approach and will (among others) develop a mediation mechanism to solve differences of opinion between two competent authorities in multi-jurisdictional cases. For this tool to be effective, we need an active industry, willing to report to us any differences in the application of rules you may experience across jurisdictions in those cases. I trust that in this respect the industry will play its part with gusto.

Now that our preliminary report has been finalized, the question arises "how to proceed?". Based on the positive responses to the presentation of our report in the FSC of last month and in a seminar on supervisory convergence, organized by the Dutch Ministry of Finance, earlier this month in The Hague, I am confident that the issue of supervisory convergence will remain a high priority in the near future. In the context of the FSC, we have agreed to have further discussions early Spring next year. To all of you I say: do not wait, the ball is in your park too as the Himalaya-report is open for consultation until 31 January 2005.



SUMMARY

In conclusion, allow me to summarize the main points in our report:

- To make the system of home/host really work in a credible way, all regulators need the minimum of equivalent powers, resources and the possibilities to cooperate;
- Level 3, the network has achieved a great deal and indeed can even do more, but it has its limits. In the first place, it cannot jump over its own shadow - its voluntary nature. In the second place, now that level 3 is considered to be crucial and should expand, the problem of the (lack of) European institutional accountability becomes urgent and should be solved;
- The need for greater trans nationality of decision-making is drawing ever nearer and is much closer than it was four years ago. It is therefore time to explore the areas where this might be appropriate, such as the delegation of powers from one national supervisor to the other and the European decision, in areas like the authorisation and issuing of permits for credit rating agencies. European decisions can only be introduced after rigorous testing which focuses (among others) on necessity and subsidiary.
- The ideas on which the Himalaya-report is based, are: the need to maintain subsidiarity, the need to work in sync with the natural evolution of the markets and to gear our instruments to the differing rates of integration. We regulators need a varied and sophisticated toolbox that will equip us to face a wide range of differing situations, that is capable of being adapted to the process of integration of securities markets.

Ladies and gentlemen, I am quite aware that it is not yet time for decision-making, but we, members of CESR, are convinced that the time has come for intense discussion so that the thinking of all parties involved in this dialogue can evolve appropriately. You should not only take active part in the discussion (of which, I am sure you will), but, in particular, it would be helpful to gain a sense from the market as to the time that we have available for this discussion and for the full decision-making process to run its full course. To give you an exaggerated example, if you will send us the message that we have a decade, then it will take us a bit longer than a decade. So my humble request is: consider the time table that you deem appropriate and broadcast this message loud and clear. Not do so, would I am sure, represent the first time that the City has not been heard loud and clear ! So, I believe to have a good reason to hope for the best. Thank you.