

The proposed EU, US and international supervisory architecture

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International Centre for
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The changing global supervisory landscape

“The financial turmoil that has unfolded over the last year has tested the ability of regulatory authorities to respond effectively to financial crises. It is evident that a number of countries need to revise and reform financial regulatory structures”

- Paul Volcker, Chairman of the Group of Thirty's Board of Trustees (2008)

Financial supervision approaches

Institutional

- The institutional approach is one in which a firm's legal status (for example, a bank, broker-dealer, or insurance company) determines which regulator is tasked with overseeing its activity from both a safety and soundness and a business conduct perspective
- The jurisdictions reviewed that use the institutional approach are China, Hong Kong, and Mexico

Functional

- The functional approach is one in which supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. Each type of business may have its own functional regulator
- The countries reviewed that use the Functional Approach are Brazil, France, Italy, and Spain

Integrated

- The integrated approach is one in which a single universal regulator conducts both safety and soundness oversight as well as conduct-of-business regulation for all the sectors of financial services business
- The countries reviewed that use this approach are: Canada, Germany, Japan, Qatar, Singapore, Switzerland, and the United Kingdom

Twin Peaks

- The twin peaks approach is one in which there is a separation of regulatory functions between two regulators: one that performs the safety and soundness supervision function and the other that focuses on conduct-of-business regulation. The two countries that use the Twin Peaks Approach are Australia and the Netherlands
- A number of other jurisdictions have been engaged in debates over the adopting this type of approach, including Spain, Italy, and France

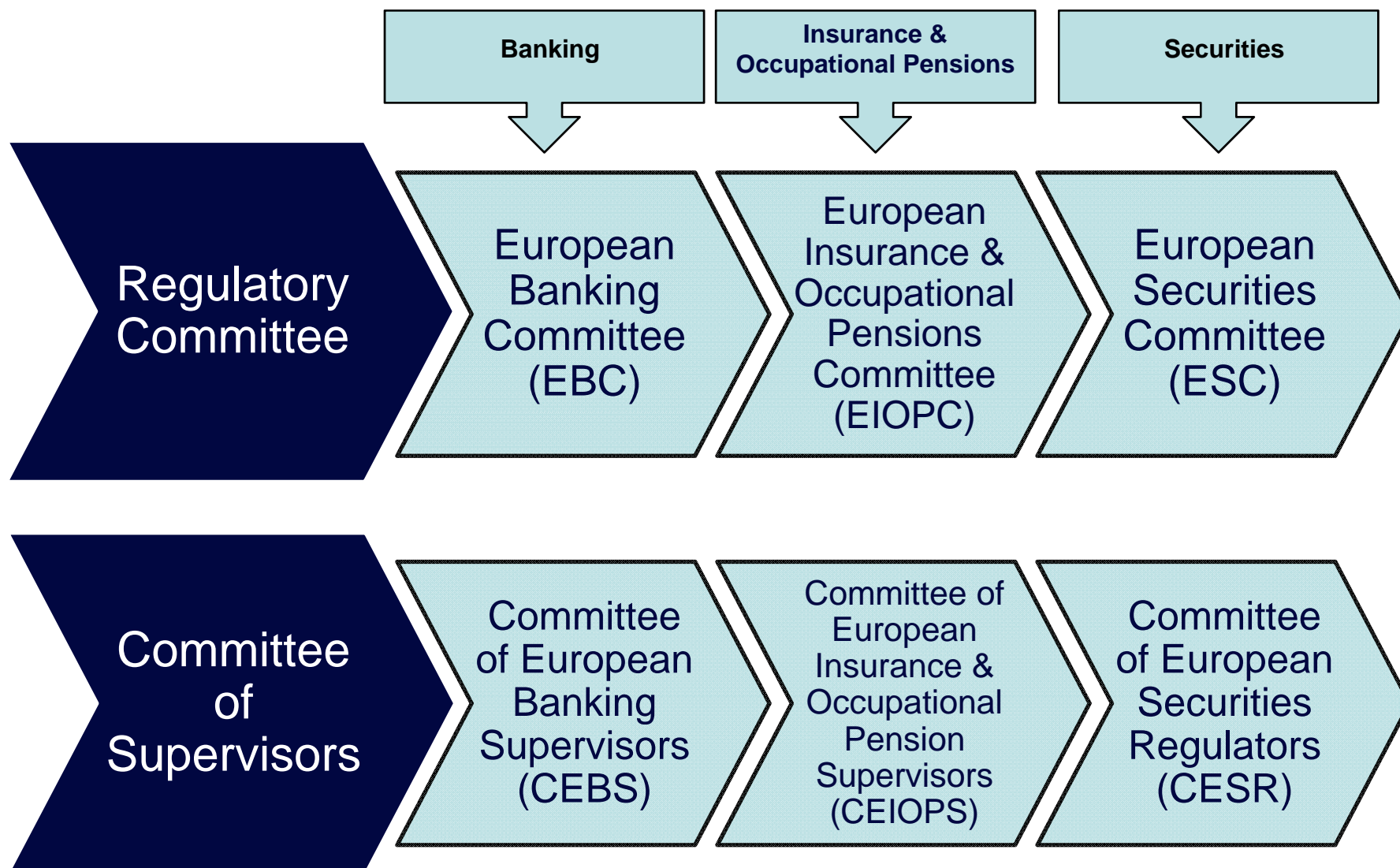
The existing EU supervisory structure

The financial supervisory system in Europe remains the remit of national member states. Differences in financial supervisors' national mandates have been said to threaten the level playing field in Europe and because financial supervisors operate under strictly national incentives, information-sharing and cooperation between them has been stated to have not been sufficient.

The main role of the existing “level 3” Committees (CESR, CEBS and CEIOPS), created in the context of the establishment of the Lamfalussy process, is to:

- improve the coordination among national regulators / supervisors and
- to ensure more consistent and timely day-to-day implementation of community legislation in Member States

Lamfalussy's Committees



EU level 3 committees

CESR

- Est. in 2001 & oldest of the Level 3 Committees
- Functions cover securities and asset management
- Members are heads of national public authorities competent in securities with 1 member on CESR for each EU Member State, Norway and Iceland

CEBS

- Est. in 2003 to cover banking
- Comprised of high level representatives from the banking supervisory authorities and central banks of the EU, Norway and Iceland

CEIOPS

- Est. in 2003 to cover insurance
- Composed of high level representatives from the insurance and occupational pension supervisory authorities from Member States of the EU, Norway and Iceland

Supervisory problems highlighted by the de Larosiere report

- Lack of adequate macro-prudential supervision
- Ineffective early warning mechanisms
- Lack of cooperation between different supervisors
- Lack of consistent supervisory powers across Member States
- No process for supervisors to take common decisions

Proposed changes to the EU supervisory structure

- Macro-prudential supervision role given to the European Central Bank (ECB)
- Creation of a new European Systemic Risk Board (ESRB) to review macro-economic conditions and prudential requirements
- Creation of a new European System of Financial Supervisors (ESFS) with existing national supervisors continuing to be responsible day-to-day supervision
- Replacing existing EU committees of Banking (CEBS), Insurance (CEIPOS) and Securities (CESR) with three new European authorities to coordinate the application of supervisory standards throughout the EU

Key tasks within new EU supervisory structure

ESRB's main tasks include:

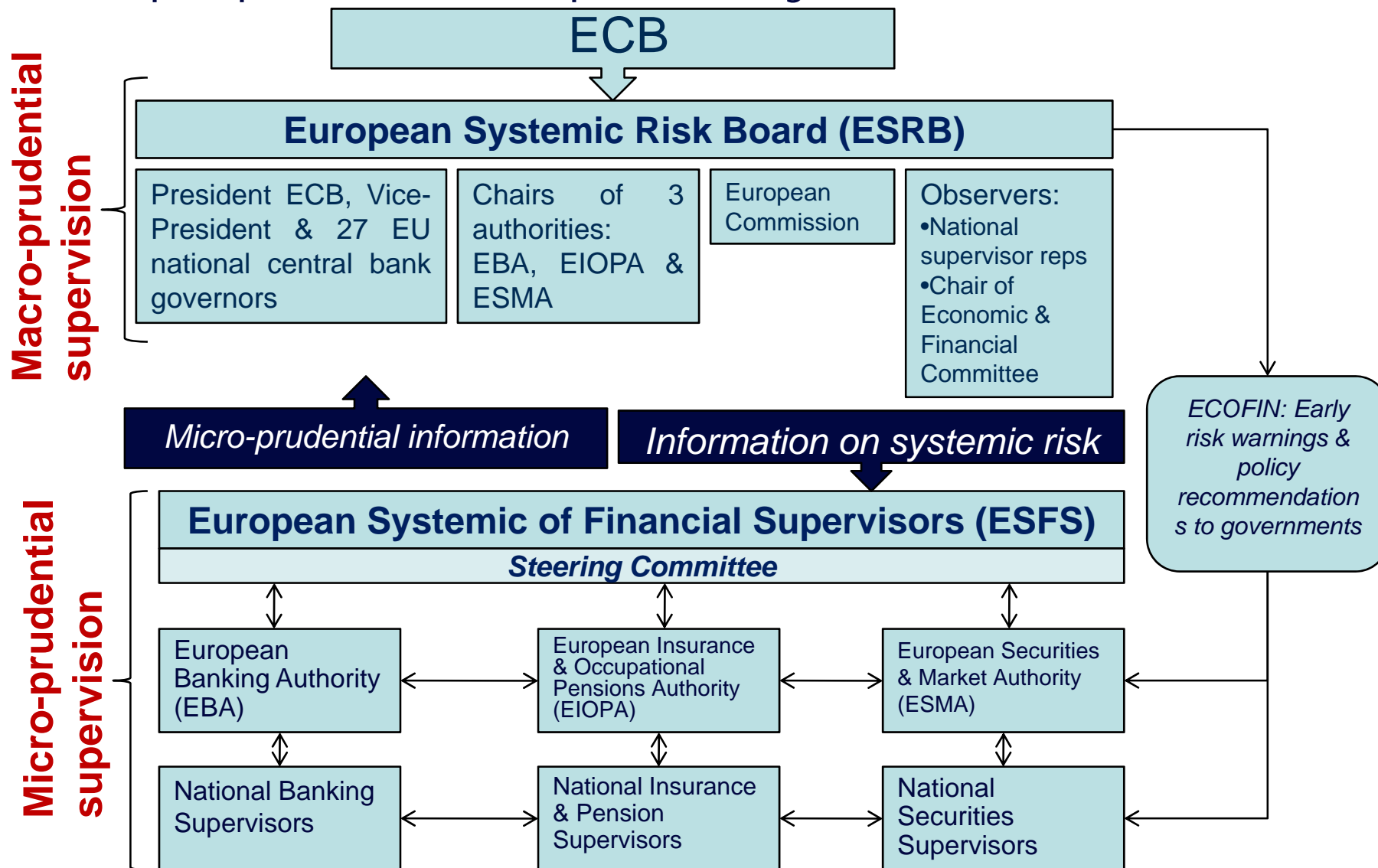
- analysis and advice on macro-prudential issues
- provision of early risk warning to EU supervisors
- comparing observations on economic developments
- providing direction and guidance

The ESRB will have no legally binding powers.

The 3 European Authorities' main tasks include:

- legally binding mediation between national supervisors
- adoption of binding supervisory standards
- adoption of binding technical decisions applicable to individual institutions
- oversight and coordination of colleges of supervisors
- licensing and supervision of specific EU-wide institutions
- strong coordinating role in crisis situations

The proposed EU supervisory structure



The existing US supervisory structure

The US structure, which falls outside of the previously outlined financial supervision four approaches, combines institutional and functional approaches with the added complexity of a number of state level agencies and actors.

The current US regulatory framework for financial services providers includes:

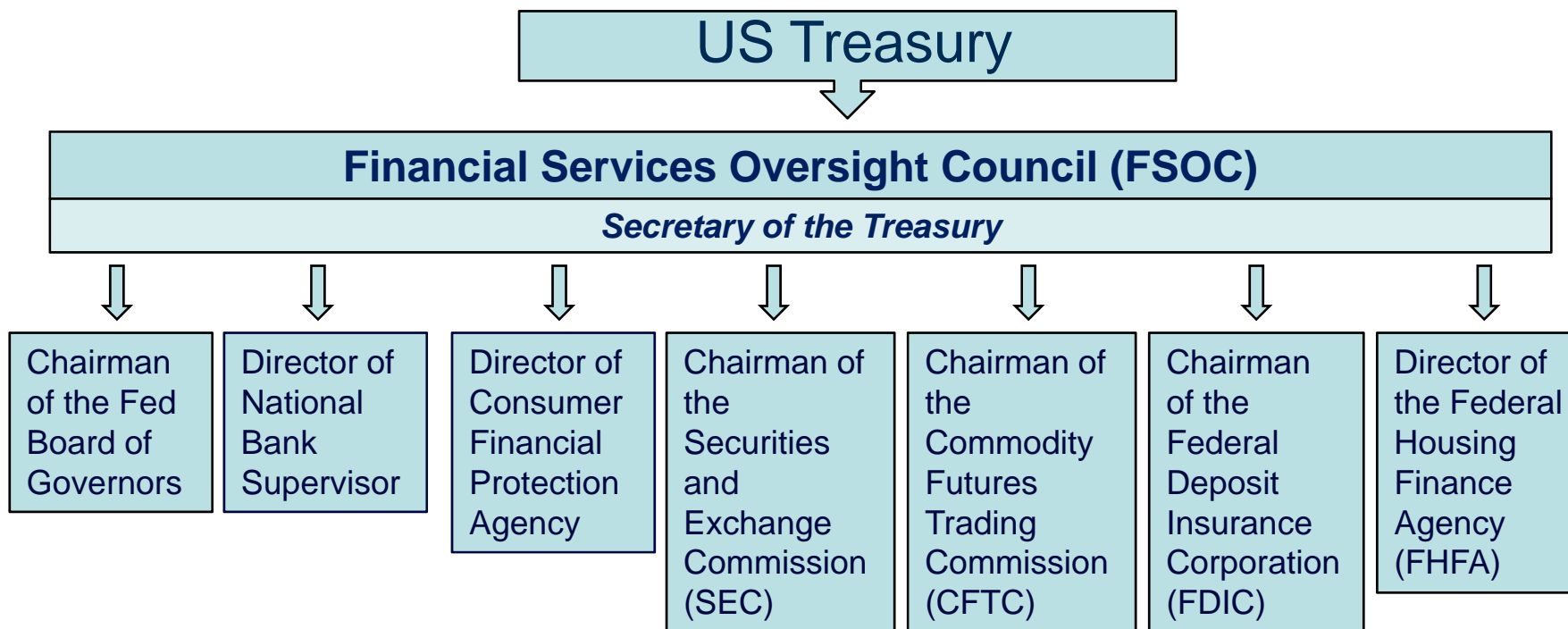
- five federal depository institution regulators in addition to state-based supervision
- one federal securities regulator, additional state based supervision of securities firms, and self-regulatory organisations with broad regulatory powers
- one federal futures regulator
- insurance regulation that is almost wholly state-based, with 50+ regulators

The changing US supervisory landscape

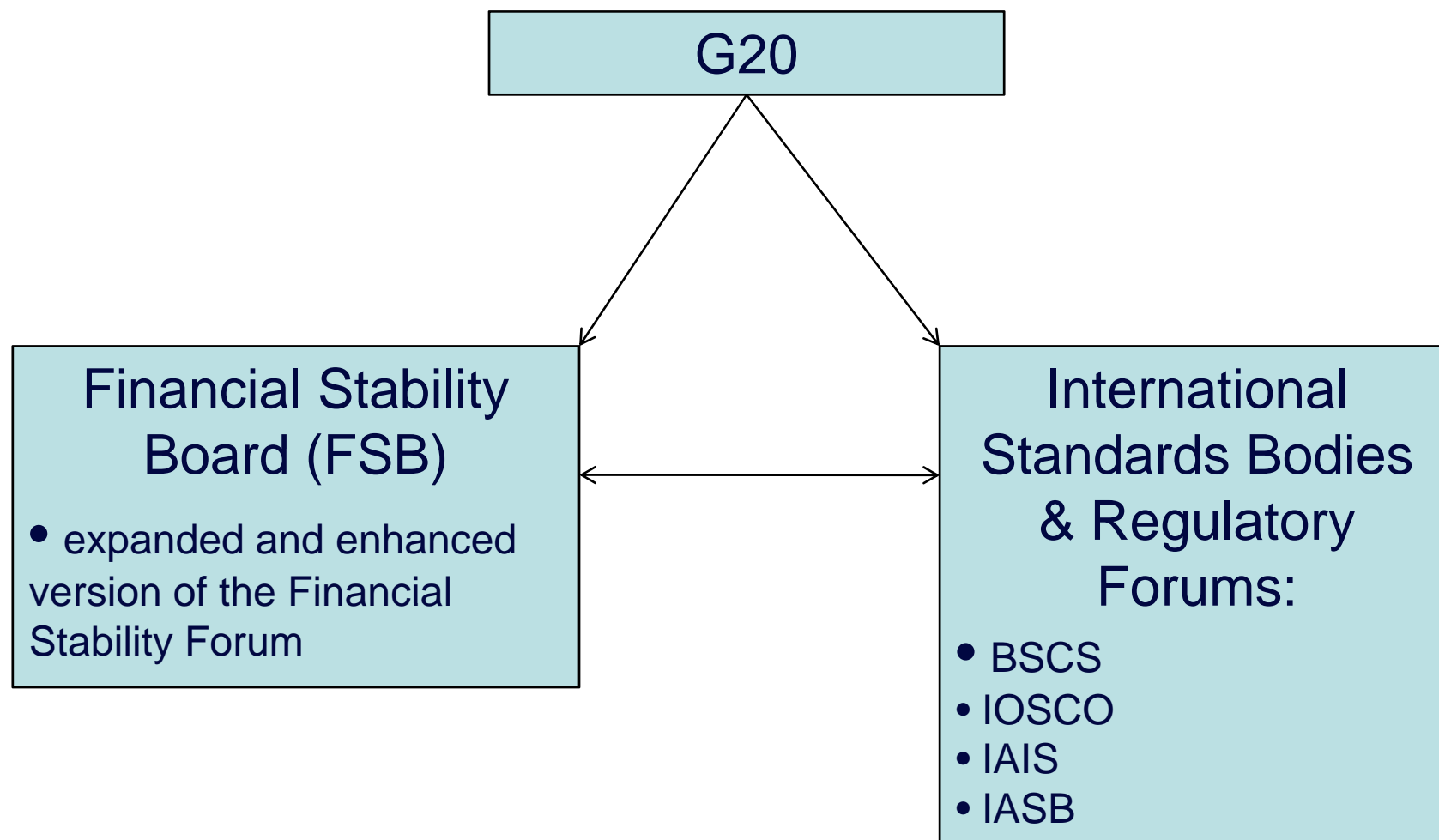
“We should and can have a structure that is designed for the world we live in, one that is more flexible, one that can better adapt to change, one that will allow us to more effectively deal with inevitable market disruptions and one that will better protect investors and consumers. The challenge is to evolve to a more flexible, efficient and effective regulatory framework...”

- Treasury Secretary Henry M. Paulson, Jr. (2008)

The proposed US supervisory structure



International institutions





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