

# *Meeting of Budget and Economic Committees Chairpersons*

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## **Towards new European framework of financial regulation and supervision**

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Prague, 27-28 April 2009



CZECH **CNB** NATIONAL BANK

# *Agenda*

- Challenges posed by modern financial market to financial regulation and supervision
- Lamfalussy framework
- De Larosière Report
- CNB position on De Larosière Report
- CNB's priorities

## *Challenges posed by modern financial market to financial regulation and supervision*

Challenges (a not exhaustive list)

- Large internationally active financial groups, balancing powers and responsibilities of home and host supervisors
- Financial innovations, namely valuation of illiquid asset backed securities
- Excessive risk taking, unwarranted leverage
- Quality of regulatory capital of financial institutions, eligibility of hybrid capital instruments into regulatory capital

## *Challenges, cont.*

- Cross-sectoral competition blurring boundaries between banking, insurance and collective investment
- Creating a regulatory and supervisory level playing field -> need for the convergence of the sectoral licensing and prudential rules, product approach, avoiding regulatory arbitrage
- Exposures of regulated financial institutions to unregulated providers of financial services, e.g. bank exposures to hedge funds or private equity capital

## *Challenges, cont.*

- Impact of cross border exposures of large financial groups on financial system stability in particular countries (e.g. Austria, Italy, Greece, Sweden, ...)
- Overloading of the lender of the last resort functionality by ballooned national financial system (e.g. Iceland)
- Procyclicality of financial system – how to dampen the effects of cyclical fluctuations of capital requirements
- Regulatory and tax havens

# *Lamfalussy framework*

EU approach to the development of financial regulation and supervision for European financial market consisting of four levels.

- European basis, Level 1: identifying new developments and the need for legislation
- Technical legal aspects, Level 2: drafting of European directives to allow effective implementation at national level
- Implementation in practice, Level 3: supervisory standards, cooperation, convergence of supervisory practices
- Check on implementation, Level 4

# *De Larosière Report*

Evolutionary approach – policy recommendations built on experience gained within the Lamfalussy framework. Covers a wide range of topics, namely:

- New regulation (accounting rules, credit rating agencies, hedge funds, common definition of regulatory capital)
- Crisis management
- Institutional structure of supervision in the EU (ESRC, ESFS)
- Global issues – common EU position to G-20 agenda
- IMF and FSF related issues

# *CNB position on De Larosière Report*

Evolutionary approach deserves merit but:

- some key recommendations to upgrade the architecture of financial supervision in the EU go too far
- cross-sectoral issues are missing

CNB in principle supports the recommendations asking for

- progress towards truly harmonised set of basic regulatory rules
- removal of national discretions and undue differences in implementation of regulatory rules,
- greater convergence of supervisory powers and procedures,
- better cross-border crisis management.



# ***CNB's position on De Larosière Report, cont.***

European Systemic Risk Council (ESRC):

ESRC's intended tasks are:

- Enhancing macro-prudential analyses
- Issuing early warnings
- Providing legally non-binding recommendations

CNB: Need for clarification of some important details concerning the statute, governance and functions of the body (supported within the ECB structure)

## *CNB's position on De Larosière Report, cont.*

CNB rejects the proposal to upgrade the European co-ordinating bodies for banking, insurance and securities supervision, and to give them more powers (establishment of the ESFS)

Such a new framework would create an asymmetry:

- the national agencies would have all the responsibilities,
- the European co-ordinating bodies would have too much power

Moreover, in case of a banking crisis, it is the national fiscal authorities who will put up the money, not the EU

## *Priorities – CNB proposals*

- Effective integration of regulation and supervision at national level as a precondition of further consolidation at EU level;
- Elimination of national discretions;
- Unification of reporting formats;
- Effective exchange of information;
- Transparent risk warning system and risk management arrangements;
- Building a common stronger position of Level 3 Committees.