COMMUNICATION FROM THE COMMISSION

European financial supervision

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1. Introduction

Experience of the financial crisis has exposed important failures in financial supervision, both in particular cases and in relation to the financial system as a whole. Current supervisory arrangements proved incapable of preventing, managing and resolving the crisis. Nationally-based supervisory models have lagged behind the integrated and interconnected reality of today's European financial markets, in which many financial firms operate across borders. The crisis exposed serious failings in the cooperation, coordination, consistency and trust between national supervisors.

The Commission has been closely involved in coordinating the substantial interventions by Member States to restore confidence in financial institutions through guarantee schemes, injection of additional capital and measures to relieve balance sheets of impaired assets, while ensuring that beneficiary institutions take the necessary steps to return to viability. This effort should be complemented by steps to address the failures in supervision revealed by the crisis.

In November 2008, the Commission mandated a High Level Group chaired by Mr Jacques de Larosière to propose recommendations to the Commission on how to strengthen European supervisory arrangements to better protect its citizens and rebuild trust in the financial system. As one of the two largest financial markets in the world, the EU also has a clear responsibility to promote global financial stability and security – a role that it can only perform if it has a strong supervisory and regulatory framework itself.

The final report presented by the de Larosière Group on 25 February 2009 set out a balanced and pragmatic vision for a new system of European financial supervision. At the core of this vision are proposals to strengthen cooperation and coordination between national supervisors including through the creation of new European Supervisory Authorities, and, for the first time, a European level body charged with overseeing risk in the financial system as a whole.

In the Communication "Driving European Recovery" of 4 March 2009¹, the Commission welcomed and supported the main thrust of these recommendations². Building on the recommendations of the de Larosière report, the Communication set out an action plan for reforming the way financial markets are regulated and supervised. The Commission has already taken a series of measures to implement the regulatory reform, including important initiatives on alternative investment funds, including hedge funds, and executive remuneration. Further measures on capital requirements for banks will follow in June.

² See the report of the High-Level Group on Financial Supervision in the EU published on 25 February 2009. The Group was chaired by Mr Jacques de Larosière.
Given the urgent need for parallel action on supervision, the Commission proposed an accelerated timetable for delivering on the reform of EU financial supervision. Discussions in the European Council, the Council and the European Parliament, as well as a public consultation, have demonstrated a broad consensus about the need for reform and the objectives to be achieved in line with the de Larosière report and the Commission's proposals for its follow-up.

This Communication is a key milestone and sets out the basic architecture for a new European financial supervisory framework. The Commission invites the European Council to endorse this architecture, as set out in the conclusions. It is envisaged that the legislative changes to give effect to the framework for EU supervision set out in this document will follow in the autumn of this year, after further consultation of stakeholders, and should be adopted in time for the renewed supervisory framework to be up and running during 2010.

The Commission welcomes reactions from stakeholders to this Communication by 15 July 2009 at the latest.

2. A NEW SUPERVISORY FRAMEWORK FOR THE EU

As announced in the Communication of 4 March 2009, the Commission will propose that an enhanced European financial supervisory framework should be composed of two new pillars (see the figure in the Annex):

- **a European Systemic Risk Council (ESRC)** which will monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole ("macro-prudential supervision"). To this end, the ESRC would provide an early warning of system-wide risks that may be building up and, where necessary, issue recommendations for action to deal with these risks. The creation of the ESRC will address one of the fundamental weaknesses highlighted by the crisis, which is the vulnerability of the financial system to interconnected, complex, sectoral and cross-sectoral systemic risks;

- **a European System of Financial Supervisors (ESFS)** consisting of a robust network of national financial supervisors working in tandem with new European Supervisory Authorities to safeguard financial soundness at the level of individual financial firms and protect consumers of financial services ("micro-prudential supervision"). The new European network will be built on shared and mutually reinforcing responsibilities, combining nationally based supervision of firms with centralisation of specific tasks at the European level so as to foster harmonised rules as well as coherent supervisory practice and enforcement. This network should be based on the principles of partnership, flexibility and subsidiarity. It would aim to enhance trust between national supervisors by ensuring, inter alia, that host supervisors have an appropriate say in setting policies relating to financial stability and consumer protection, thereby allowing cross-border risks to be addressed more effectively.

Implementing both pillars of the new supervisory system is essential: to achieve valuable synergies; to mutually reinforce the impact on financial stability; to ensure a fully connected macro-micro supervisory framework. It would be inefficient to reinforce EU financial services regulation, while preserving a supervisory system that has showed multiple deficiencies in this crisis. In parallel, differences in the national transposition of Community law stemming from exceptions, derogations, additions or ambiguities in current directives
must be identified and removed, so that one harmonised core set of standards (a single rulebook) can be defined and applied throughout the EU by all supervisors. This process could be strengthened by introducing more directly applicable rules at the EU level, where possible.

The new European financial supervisory framework must be fully accountable to political authorities in the EU. It must develop a common supervisory culture; be sensitive to the interests of all Member States — and the need for a balanced, strengthened confidence building relationship between home and host authorities. It must be a system that is based on high supervisory standards, applied equivalently, fairly and consistently to all market actors, while respecting the independence of supervisors to carry out their work.

With this initiative, the EU is not just responding to its calls in the G20 framework for international action to build a stronger, more globally consistent, regulatory and supervisory system for the future financial sector³, but also setting out a modern and comprehensive regional framework, whose principles should be taken up at international level.

3. **European Systemic Risk Council (ESRC)**

3.1. **The case for reform of macro-prudential supervision**

The weaknesses of the present arrangements for macro-prudential supervision have had dramatic consequences across the global financial system. Many of the imbalances that accumulated in the global financial system before the crisis can be attributed to excessive credit expansion and surging asset price inflation, amid a generalised under-pricing of financial risk in a period of sustained non-inflationary economic growth. Against this background, the G20 has decided to reinforce the global arrangements for safeguarding financial stability at the global level, with the newly established Financial Stability Board (FSB)⁴ expected to collaborate closely with the International Monetary Fund (IMF) to provide early warnings of macro-prudential risks at the global level. Meanwhile, the US Government plans to put in place a powerful body with responsibility for macro-prudential supervision of its domestic financial system.

Similarly, the EU needs a specific body responsible for macro-prudential supervision across the EU financial system, which would identify risks to financial stability and, where necessary, issue risk warnings and/or recommendations for action to address such risks. The present EU arrangements place too little emphasis on the macro-prudential side. Macro-prudential analysis is fragmented, executed by different authorities at different levels with no mechanism to ensure that macro-prudential risk warnings and/or recommendations are followed up and translated into action. In the run-up to this crisis, interconnected complex market risks were not properly analysed, nor were the consequences drawn for regulatory and supervisory policy. These fragmented arrangements must change because the economic costs of failure in macro-prudential supervision, as this crisis has shown, can be heavy.

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³ See the London Summit Statement of 2 April 2009.
⁴ The successor to the Financial Stability Forum (FSF).
3.2. Role and responsibilities of the ESRC

The Commission will propose that the ESRC should be established as a new independent body, responsible for safeguarding financial stability by conducting macro-prudential supervision at the European level. In order to perform this role, the ESRC should:

<table>
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<tr>
<th>Role of ESRC</th>
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<tr>
<td>- collect and analyse all information relevant for monitoring and assessing potential threats to financial stability that arise from macro-economic developments and developments within the financial system as a whole;</td>
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<td>- identify and prioritise such risks;</td>
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<td>- issue risk warnings where risks appear to be significant;</td>
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<td>- where necessary give recommendations on the measures to be taken in reaction to the risks identified;</td>
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<tr>
<td>- monitor the required follow-up to warnings and recommendations, and</td>
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<tr>
<td>- liaise effectively with the IMF, the FSB and third country counterparts.</td>
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The main task of the ESRC would be assessments of stability across the EU financial system in the context of macro-economic developments and general trends in financial markets. If significant stability risks are foreseen, the ESRC would provide early warnings and, where appropriate, issue recommendations for remedial action. The warnings and recommendations issued by the ESRC could be of a general nature or could concern individual Member States and there would be a specified timeline for the relevant policy response. These warnings and/or recommendations would be channelled through the ECOFIN Council and/or the new European Supervisory Authorities. The ESRC would also be responsible for monitoring compliance with its recommendations, based on reports from the addressees.

The ESRC would not have any legally binding powers. However, the ESRC would be expected to exert major influence on the addressees of warnings/recommendations through the high quality of its analysis and the participation in its work of all EU central bank governors and supervisors and the Commission. The addressees of warnings and recommendations would therefore be expected to act on them unless inaction could be adequately justified. In short, the follow-up to warnings and recommendations would be ensured by an "act or explain" mechanism. The ESRC would decide in each case whether a recommendation should be kept confidential or made public, on the basis of its own judgement. However, bearing in mind that the recommendations by the ESRC would not be binding, public disclosure would be expected to increase their effectiveness.

The ESRC would be fully accountable to the Council and the European Parliament. Accountability would take the form of regular (i.e., at least bi-annual) reporting to these institutions. More frequent reporting would be likely in the event of widespread financial distress, although it should be noted that the ESRC would not have any direct crisis management responsibilities.
3.3. Composition and functioning of the ESRC

Central banks should have a leading role in macro-prudential supervision. The main responsibilities of central banks relate to the maintenance of monetary and financial stability. Indeed, the analysis necessary for carrying out macro-prudential tasks can partly be based on the economic and monetary analyses undertaken by central banks for the formulation of monetary policy, although additional information and analysis of vulnerabilities in the financial system would also be required. Furthermore, central banks have a crucial financial safety net function through their role as lenders of last resort. As safeguarding financial stability is a fundamental responsibility of central banks, the Commission will propose that the ESRC would include the central bank governors of the 27 Member States and the President of the ECB. Participation in the ESRC will not prejudice any existing financial stability responsibilities.

The participation of micro-prudential supervisors in the work of the ESRC is also indispensable. The interconnectedness of financial institutions and markets clearly implies that the monitoring and assessment of potential systemic risks should be based on a broad set of relevant macro-economic and micro-financial data and indicators. Micro-prudential supervisors have detailed knowledge of developments in financial markets and in major firms and will have critical information to assess stability risks. For these reasons, the chairpersons of the three European Supervisory Authorities of the ESFS as well as senior representatives of the national supervisory authorities should be involved. To ensure that the ESRC can work efficiently, the membership of supervisors in the ESRC would be limited to the three chairpersons of the European Supervisory Authorities. However, each central bank governor should be accompanied by one senior representative of the national supervisory authorities as observer (i.e., a 1+1 formula). The representative accompanying the central bank governor could vary from meeting to meeting, depending on the issues to be discussed by the ESRC, in particular in those Member States where there are several supervisory authorities.

A member of the Commission would also have membership in the ESRC, notably because of the Commission's Treaty-based responsibilities for macro-economic surveillance. It regularly monitors and analyses macroeconomic developments and policies and identifies macro-financial risks. It has both the necessary country-specific expertise and an EU-wide perspective and so would be well placed to contribute to the work of the ESRC.

Participation of Finance Ministries in the ESRC could be perceived as blurring its role in providing independent technical analysis of macro-prudential risks. However, as budgetary and/or taxation policies can contribute to or mitigate financial-stability risks, the Economic and Financial Committee (EFC) chairperson would represent the finance ministries by participating as an observer in ESRC meetings. This would also reflect the role of finance ministries in crisis management and resolution and ensure a smooth flow of information between the ESRC and the political authorities.

Meetings of the ESRC would be held at least quarterly, with more frequent meetings held in times of stress in the financial system. All ESRC members and observers would have the right to attend and to speak at these meetings. In order to streamline the decision-making process, however, only ESRC members would have the right to vote, i.e. only the President of the ECB, national central bank governors, the chairmen of the European Supervisory Authorities and the Commission member. Votes would not be weighted and decisions would be taken by a simple majority.
In line with the recommendation made in the de Larosière report, the chairperson of the ESRC should be the ECB President (in which case, the chairperson of the ESRC being independent, the ECB Vice-President should also be a member). As the chairperson comes from a central bank within the Eurosystem, it would seem appropriate that a vice-chairperson should be elected from among those Member States outside of the euro area.

A small steering committee – consisting of the ESRC chairperson and vice-chairperson, five additional central bank members of the ESRC, the chairpersons of the new European Supervisory Authorities and the Commission member - should be established to prepare and ensure efficient ESRC meetings. In addition, an advisory technical committee should be established to support the ESRC, including preparing detailed technical analysis of financial stability issues. In performing its duties, it would seem advisable that the ESRC should also seek the advice of private-sector stakeholders, including consumer representatives. The ECB will provide the Secretariat to the ESRC as well as analytical, administrative and logistic support.

The ESRC would closely collaborate with the IMF, the FSB and third country counterparts in the context of an early warning system at the global level, for example by drawing attention to potential risks in the global financial system outside of the EU. In this way, the ESRC would be expected to increase the influence of the EU in any global risk warning system.

3.4. Legal basis for the ESRC

Only with arrangements in place that properly acknowledge the interdependence between micro- and macro-prudential risks can all stakeholders, e.g. financial institutions, investors and consumers, have sufficient confidence to engage in cross-border financial activities. Too often in the past, the focus of prudential supervision has been exclusively at the micro-level, with supervisors assessing the balance sheets of individual financial institutions without due consideration for interactions between institutions and between institutions and the broader
financial system. Providing this broader perspective is the responsibility of macro-prudential supervisors. These supervisors shall monitor and assess potential financial-stability risks arising from developments that can impact on a sectoral level or at the level of the financial system as a whole. By addressing such risks, the ESRC would be an essential building block for an integrated EU supervisory structure necessary to promote timely and consistent policy responses among the Member States thus preventing diverging approaches and so improve the functioning of the Internal Market. In addition, as an integral part of the legal and institutional framework, the ESRC will facilitate the consistent, coherent and effective implementation and application of Community rules for cross-border financial services.

Having considered a range of possible options, the Commission considers it appropriate that the ESRC should be established on the basis of Article 95 of the EC Treaty as a body without legal personality. This legal basis would allow the ESRC to have the core features outlined above and to have a mandate covering the whole financial sector without exceptions, including insurance. Moreover, it would allow the ESRC, together with the ESFS, to form a common innovative framework for financial supervision, while maintaining a clear distinction of responsibilities between the ESRC and the other institutions. This choice of legal base does not prevent the conferring of responsibilities on the ECB in respect of tasks in respect of the ESRC by means of an act adopted on the basis of Article 105(6) of the EC Treaty.

4. European System of Financial Supervisors (ESFS)

4.1. The case for micro-prudential reforms

On micro-prudential supervision, the EU has reached the limits of what can be done with the present status of the Committees of European Supervisors\(^5\) (Level 3 Committees) - which remain advisory bodies to the Commission. In spite of a number of improvements to these Committees, the EU cannot remain in a situation where there is no mechanism to ensure that national supervisors arrive at the best possible supervisory decisions for cross-border institutions; where there is insufficient cooperation and information exchange between national supervisory authorities; where joint action by national authorities requires a tour de force to take account of the patchwork of regulatory and supervisory requirements; where national solutions are most often the only feasible option in responding to European problems, where different interpretations of the same legal text abound. The new ESFS will be designed to overcome these deficiencies and provide a system that is in line with the objective of a stable and single EU financial market for financial services – linking national supervisors into a strong Community network.

4.2. Role and responsibilities of the ESFS

The ESFS should become therefore an operational European network with shared and mutually reinforcing responsibilities. At the EU-level, the three existing Committees of Supervisors would be replaced by three new European Supervisory Authorities, i.e., a European Banking Authority (EBA), a European Insurance and Occupational Pensions Authority (EIOPA), and a European Securities Authority (ESA), which would each have legal personality. These new European Supervisory Authorities will take on all the missions of the

\(^5\) Committee of European Banking Supervisors (CEBS), Committee of European Insurance and Occupational Pensions Committee (CEIOPS) and the Committee of European Securities Regulators (CESR), also often known as the "Lamfalussy level 3 Committees".
current Committees of Supervisors\textsuperscript{6}, but in addition have increased responsibilities, defined legal powers and greater authority (see below). They would also contribute to the development of a single set of harmonised rules, improve the supervision of cross-border institutions by developing common supervisory requirements and approaches and help settle possible disputes between national supervisors.

The focal point for day to day supervision would remain at the national level, with national supervisors remaining responsible for the supervision of individual entities, for example with respect to capital adequacy. This reflects, for the time being, that the financial means for rescuing financial institutions remains at the Member State level and with national tax payers, as the current crisis has demonstrated. For cross-border institutions, the colleges of supervisors which are being set up\textsuperscript{7} will be the lynchpin of the supervisory system and should play an important role in ensuring a balanced flow of information between home and host authorities. The European Supervisory Authorities should participate in meetings of the colleges of supervisors, as observers, so as to contribute to the emergence of a common supervisory culture and consistent supervisory practices. Set up in this way, the ESFS will combine the advantages of an overarching European framework for financial supervision with the expertise of local supervisory bodies that are closest to the institutions operating in their jurisdictions.

In order for the ESFS to work effectively, flanking measures and changes to the sectoral legislation will be needed to ensure a more harmonised set of financial regulations. The goal will be to bring about more harmonisation in the rules that have to be applied by supervisors as well as greater consistency in the national powers and sanctions available to them. On the latter, the Commission will come forward with proposals in the autumn.

To achieve its objectives, the new European Supervisory Authorities will need to be equipped to fulfil the following functions:

\textit{(1) Ensure a single set of harmonised rules}

The Authorities will:

- develop binding technical standards in specific areas and on the basis of criteria which will be specified in Community legislation (e.g. supervisory standards for colleges of supervisors and technical standards for internal model validation). Such standards shall apply within a fixed period of time, provided the Commission endorses by non-opposition, and

- draw up interpretative guidelines, which the competent national authorities would apply in taking individual decisions, notably as regards the licensing and supervision of financial institutions.

\textsuperscript{6} e.g., giving technical advice to the European Commission.

\textsuperscript{7} Regarding the major financial groups in the EU, colleges already exist or are being set up in 2009.
Ensure consistent application of EU rules

Even with a single set of harmonised rules, the application of these rules may, in occasional cases, lead to differences of opinion on the application of Community legislation. The European Supervisory Authorities should therefore have, in cases clearly specified in Community legislation, the means to ensure coherent application of Community legislation.

- Disagreement between national supervisors

In the case of diverging opinions between national supervisory authorities, the European Supervisory Authorities should facilitate a dialogue and assist the supervisors in reaching a joint agreement. If, after a phase of conciliation, the latter have not been able to reach an agreement, the European Supervisory Authorities should, through a decision, settle the matter. However, this would clearly be a last resort option as in most cases the respective national authorities should be able to come to an agreement in the preceding conciliation procedure.

- Manifest breach of Community Law

A mechanism should also be put in place to address behaviour by a national supervisory authority which is considered to be manifestly diverging from the existing Community legislation. The European Supervisory Authorities, on their own initiative or upon request from one or more national supervisors or from the Commission, would investigate the issue and, if necessary, adopt a recommendation for action addressed to the relevant national supervisor.

Within the general duty of compliance with Community legislation the national authority would be called to comply with the recommendation within a fixed period of time. On the rare occasion that the situation would pertain, the European Supervisory Authorities would inform the Commission of the particular case. The Commission could, shortly after the adoption of the European Supervisory Authorities' recommendation, take a decision, requiring the national supervisory authority to either take specific action or to refrain from action in order to ensure full compliance with the acquis communautaire in the area of financial services.

In order to overcome inaction in relation to the implementation of Community law or delaying of action by national supervisors or in case of need for urgent action, the European Supervisory Authorities could also be empowered to adopt decisions directly applicable to financial institutions in relation to requirements stemming from EU Regulations relating to the prudential supervision of financial institutions and markets as well as the stability of the financial system. These decisions would be without prejudice to the initiation of infringement proceedings by the Commission against Member States.

Ensure a common supervisory culture and consistent supervisory practices

The new European Supervisory Authorities will build a common European supervisory culture and consistent supervisory practices, for example by developing common training programmes and participating in meetings of the colleges of supervisors as an observer. They could also promote the use of delegation of tasks and responsibilities from one national supervisory authority to the other.
(4) **Full supervisory powers for some specific entities**

The European Supervisory Authorities shall be given the responsibility for the authorisation and supervision of certain entities with pan-European reach, e.g., credit rating agencies and EU central counterparty clearing houses. These responsibilities could include such powers as those of investigation, on-site inspections and supervisory decisions. These responsibilities would be defined in sectoral legislation (e.g., the Regulation on Credit Rating Agencies). Apart from reinforcing the effectiveness of supervision, this could enhance efficiency by creating a 'one-stop shop' for these supervised institutions. The European Supervisory Authorities could also be involved in the prudential assessment of European mergers and acquisitions throughout the financial sector.

(5) **Ensure a coordinated response in crisis situations**

The European Supervisory Authorities should have a strong coordinating role in crisis situations: they should facilitate cooperation and exchange of information between the competent authorities, act as mediator when needed, verify the reliability of the information that should be available to all parties and help the relevant authorities to define and implement the right decisions. As for the latter, the introduction of a European mandate by mid-2009 will allow national authorities to consider financial stability concerns in other Member States when exercising their duties. In this respect progress on burden sharing and resolution mechanisms is critical to reinforcing trust between national authorities and strengthening the functioning of the ESFS, work which must advance as soon as possible. In specific crisis situations, the European Supervisory Authorities could have the power to adopt some emergency decisions (e.g. on short-selling) - the scope of these emergency procedures should be defined in Community legislation.

(6) **Collect micro-prudential information**

The European Supervisory Authorities should be responsible for the aggregation of all relevant micro-prudential information emanating from national supervisors. To this end a central European database should be established and managed by the European Supervisory Authorities. The information would be available for the relevant authorities in colleges of supervisors and may be forwarded in aggregated and/or anonymous format to the ESRC (see section 5). To this end, existing sectoral legislation may need to be amended.

(7) **Undertake an international role**

Without prejudice to the institutional competences of the European Institutions, the European Supervisory Authorities could be given a certain role as regards international activities, including technical arrangements with international organisations and with the administrations of third countries at its level. The European Supervisory Authorities could also assist the Commission in preparing equivalence decisions pertaining to supervisory regimes in third countries.

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8 The Commission would remain exclusively competent to apply the EU State aid rules and, for Community dimension mergers, to assess the competition aspects of such transaction in line with the EC Merger Regulation.
Safeguards

The framework for the exercise of the above competences will be specified exhaustively and in precise detail in the relevant sectoral legislation. The conferring of these competences will be in full conformity with Articles 226 and 228 of the Treaty. Without prejudice to the application of Community law, and recognising the potential liabilities that may be involved for Member States, decisions under the above mechanisms shall not directly impinge on the fiscal responsibilities of the Member States. Moreover, any decision by the European Supervisory Authorities or the Commission must be subject to review by the Community Courts.

4.3. Composition and operational structure of the ESFS

The network approach to supervision described above, with the new European Supervisory Authorities working in tandem with the national financial supervisors, is proposed in line with the de Larosière report, as opposed to solutions such as full centralisation of supervision at the EU level, on which there is no consensus. However, given the urgency to improve the quality and coherence of supervision in Europe, the Commission considers it necessary to accelerate the preparatory work proposed by the de Larosière Group, so that the strengthened framework will be up and running in 2010.

The Commission recognises that there is a vigorous – and so far inconclusive - debate within many countries in the world on the most appropriate supervisory structure, with options including: (i) one single supervisor for all sectors, (ii) separate supervisors for prudential and conduct-of-business supervision for all financial institutions combined (the so-called "twin peaks" model), and (iii) a sectoral approach (i.e., separate supervisors for banking, insurance companies and securities activities). However, in the Commission's view, at this point in time it is preferable to maintain the latter approach at European level, building upon the existing structures given that there is no persuasive evidence to suggest that other structures would be more efficient for the specific competences which are proposed for the European Supervisory Authorities. These competences are not mainly composed of direct supervision, and therefore the arguments and evidence adduced in national debates on supervisory structure cannot necessarily be applied to them. For these reasons, the Commission will propose to build on the existing structure and, when necessary, allow it to evolve over time, with a review after a fixed number of years.

Within the proposed structure, cross-sectoral cooperation will however be fundamental so as to reflect the relevant market trends and realities. To the extent that the degree of convergence between sectors will continue, the three European Supervisory Authorities and a representative of the Commission would increasingly need to evaluate the respective sectoral regimes to identify common principles and understanding possible differences. An overarching steering committee should therefore be formally introduced in the structure to ensure mutual understanding, cooperation and consistent supervisory approaches between the three new European Supervisory Authorities in addressing cross-sectoral challenges, including financial conglomerates, and ensuring a level playing field. In addition, each European Supervisory Authority should have the possibility to participate in meetings of the other European Supervisory Authorities as an observer.

Each new Authority would have a Board of Supervisors comprised of the highest-level representatives from the appropriate national supervisory authorities and chaired by the chairperson of the respective European Supervisory Authority. Representatives from the
Commission, the ESRC and the relevant supervisory authorities from EFTA-EEA countries should take part in the Board of Supervisors as observers. However, they would not be able to attend any discussions pertaining to individual institutions. In line with current practice, a Management Board should also be set up to deal with general operational issues (budget etc.) and would include the Commission. The chairpersons and secretary generals of the European Supervisory Authorities should be full-time independent professionals. The chairperson will be nominated after an open competition. Appointment would be confirmed by the European Parliament and should be valid for a period of 5 years.

**Composition of the European System of Financial Supervisors**

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<tr>
<th>I. Steering Committee:</th>
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<td>– Representatives of the three European Supervisory Authorities and the Commission.</td>
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<tr>
<th>II. Three European Supervisory Authorities [the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities Authority (ESA)]:</th>
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<tr>
<td>Board of Supervisors of each European Supervisory Authority:</td>
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<tr>
<td>– Chairperson of the European Supervisory Authorities, and</td>
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<td>– Chairpersons from the appropriate national supervisory authorities.</td>
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<tr>
<td>Observers:</td>
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<tr>
<td>– A Commission representative;</td>
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<tr>
<td>– A representative of the ESRC, and</td>
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<tr>
<td>– A representative from the appropriate national supervisory authority of each EFTA-EEA country.</td>
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<th>Management Board of each European Supervisory Authority:</th>
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<tr>
<td>– Representatives from the appropriate national supervisory authorities and the Commission.</td>
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<th>III. National supervisory authorities</th>
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The Board of Supervisors should meet on a regular basis, with additional meetings held in times of stress. The European Supervisory Authorities’ decisions on technical rules would be taken, through the board structure, by qualified majority based on the Treaty weighting for Member States. Separate arrangements should be considered for dealing with other functions of the European Supervisory Authorities. For example, decisions on the application of existing laws should be taken by simple majority on the basis of "one person, one vote".

The European Supervisory Authorities would each have their own budget, subject to discharge by the European Parliament. Their resources could stem from the EU budget as well other sources such as contributions by the national authorities. Any budgets would have to be commensurate with their responsibilities, and ensure independence. The European Supervisory Authorities should liaise in a structured way with all relevant stakeholders, including consumers.

Ensuring the independence of these European Supervisory Authorities will be crucial. They would need the highest degree of independence vis-à-vis national authorities other than
supervisors and vis-à-vis the European Institutions, which should not interfere in the decisions of the European Supervisory Authorities. The European Supervisory Authorities would however be fully accountable to the Council, the European Parliament and the Commission. Transparency would be a key instrument to make this work and the European Supervisory Authorities would have to report formally to the European Institutions on a frequent basis (e.g., at least bi-annually).

4.4. Legal basis for the ESFS

The legal basis for establishing the European Supervisory Authorities should be the provision of the EC Treaty which constitutes the specific legal basis for the policy they will be called upon to implement.

The financial and economic crisis has created risks to the stability of the internal market. Restoring and maintaining a stable and reliable financial system is an absolute prerequisite to preserving trust and coherence in the internal market, hence to preserve and improve the conditions for the establishment of a fully integrated and functioning internal market in the field of financial services. Moreover, deeper and more integrated financial markets offer better opportunities for financing and risk diversification, and thus help to improve the capacity of the economies to absorb shocks. Financial integration and stability are therefore mutually reinforcing.

The establishment of the ESFS, and the three European Supervisory Authorities, will be accompanied by the development of a single rule book which will ensure uniform application of rules in the EU and thus contribute to the functioning of the internal market. The task of the European Supervisory Authorities will be to assist the national authorities in the consistent interpretation and application of the Community rules.

The Court of Justice has acknowledged that Article 95 of the EC Treaty relating to the adoption of measures for the approximation of legislation for the establishment and functioning of the internal market provides an appropriate legal basis for setting up a "Community body responsible for contributing to the implementation of a process of harmonisation", when the tasks conferred on such a body are closely linked to the subject-matter of the acts approximating the national legislations.

The tasks to be conferred on the European Supervisory Authorities being thus closely linked to the measures put in place as a response to the financial crisis and to those announced in the Communication on "Driving European recovery", they can, thus, in line with the Court's case law, be established on the basis of Article 95 of the EC Treaty.

5. Cooperation between the ESFS and the ESRC

The proposed framework for EU supervision can only work if the ESRC and ESFS cooperate efficiently. Indeed, the objective of the reform is to ensure a smoother interaction of supervision at the macro-prudential and micro-prudential levels. In fulfilling its role as macro-prudential supervisor, the ESRC would need a timely flow of harmonised micro-level data, while micro-prudential supervision by national authorities would benefit from the ESRC’s insights into the macro-prudential environment. Binding cooperation and information sharing

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See CJCE, C-217/04, pt. 44.
procedures between the "micro" and the "macro" levels would be of fundamental importance, if the pitfalls from the past are to be avoided.

In order to identify and prioritise risks to the stability of the EU financial system, the ESRC would need to: (i) receive relevant micro-prudential data - notably on large and complex cross-border groups- from the ESFS, and (ii) have the possibility to launch ad-hoc surveys on specific issues requiring direct input from national supervisors and/or the market operators. The Commission will propose that the necessary information would be passed to the European Supervisory Authorities by the national supervisory authorities in application of the rules establishing the new European Supervisory Authorities. The powers to receive all information relevant for financial stability could be attributed to the ESRC by a combination of the legal instrument establishing the ESRC and the legal instruments establishing the new European Supervisory Authorities. Meanwhile, the Regulations establishing the new European Supervisory Authorities would require them to periodically (e.g., on a monthly basis) provide the ESRC with aggregated and relevant anonymous disaggregated data on all financial institutions and markets, but notably on large and complex cross-border groups. Given the sensitivity of the data and information, ensuring necessary confidentiality in the cooperation between the ESRC and the ESFS would be crucial and adequate legal safeguards should be in place. In addition, for the colleges to receive up-to-date information on the macro-prudential environment in which individual institutions operate, the participation of ESRC representatives as observers could be envisaged.

6. CONCLUSION

The Commission invites the European Council to:

- endorse the creation of a new European Systemic Risk Council (ESRC), chaired by the ECB President and including governors of national central banks, the chairpersons of the three European Supervisory Authorities and a member of the European Commission. There should also be close involvement of national supervisory authorities and the chair of the Economic and Financial Committee in the work of the ESRC;

- agree that the ESRC will be charged with continuously assessing the stability of the financial system as a whole and be given the necessary authority to issue timely warnings/recommendations for remedial action and to monitor responses;

- agree on the establishment of a new European System of Financial Supervisors (ESFS) composed of 3 new European Supervisory Authorities working in a network with national supervisory authorities to develop common supervisory approaches to the supervision of all financial firms, to protect consumers of financial services and to contribute to the development of a single set of harmonized rules. Inter alia, the ESFS should draw up technical standards, help ensure the consistent application of Community law and resolve disputes between supervisors;

- underline the importance of a truly integrated approach to European financial supervision: the need for strong interaction between the ESRC and the ESFS including the exchange of micro-prudential information relevant for macro-prudential analysis; the willingness of the relevant parties to act upon risk warnings and/or recommendations; and the need for the ESRC to act as an interface with international institutions notably the FSB and IMF;
– welcome the Commission's intention to bring forward, as soon as possible, the legislative changes to put in place the new framework for EU supervision, on the basis of the orientations set out in this Communication and after further consultation of stakeholders, so that the necessary measures are adopted in time for the renewed framework to be up and running during 2010;

– in addition, support the acceleration of work to build a comprehensive cross border framework to strengthen the European Union's financial crisis management/resolution systems, including guarantee schemes and burden sharing.
Annex:

A new European Framework for Safeguarding Financial Stability

European Systemic Risk Council (ESRC)

EU Members:
- Chair: ECB President
- Vice-Chair
- Central bank Governors
- ECB Vice-President
- European Commission
- Chair of the European Supervisory Authorities

Observers:
- Representatives of national supervisors
- Chair of the Economic and Financial Committee

Macro-prudential supervision

Early risk warning and recommendations to governments

ECOFIN

European System of Financial Supervisors (ESFS)

Steering Committee

European Banking Authority (EBA)

European Insurance and Occupational Pensions Authority (EIOPA)

European Securities Authority (ESA)

National Banking Supervisors

National Insurance and Pension Supervisors

National Securities Supervisors

Micro-prudential supervision

Early risk warning and recommendations to supervisors

Micro-prudential supervision

Macro-prudential supervision