Opinion of the European Economic and Social Committee on the 'Report of the de Larosière Group' (Own-initiative opinion)

(2009/C 318/11)

Rapporteur: **Mr NYBERG**

On 23 March 2009 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an own-initiative opinion on the

'Report of the de Larosière Group.'

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 11 September 2009. The rapporteur was Mr NYBERG.

At its 456th plenary session of 30 September and 1 October 2009 (meeting of 30 September), the European Economic and Social Committee adopted the following opinion by 152 votes to 37, with 15 abstentions.

1. Conclusions and recommendations

1.1 The current financial and economic crisis is on a scale the likes of which the world has not seen in peacetime since the 1930s. However, the present opinion focuses exclusively on the financial crisis and what can be done to prevent it recurring in the future. This was the brief entrusted to the de Larosière Group, whose report is the subject of the present EESC opinion. One indication of the just how important these issues are is the fact that the European Commission has already put forward proposals for changes to EU legislation, for example on credit rating agencies, on various types of financial activity and on financial supervision, which was the main topic addressed by the de Larosière Group.

1.2 The primary cause of the crisis was excess liquidity, which, according to the de Larosière Group, was due, in part, to expansionary monetary policy in the United States and imbalances in the world economy, most clearly so in relations between the US and China. The EESC believes that another conceivable explanation is that there has been a shift in income distribution away from labour income to capital income. The distribution of income has become more uneven. The wealthiest needed to find an investment outlet for their increased assets. As the opportunities for real investment had not grown at the same pace, this put upward pressure on security prices. The de Larosière report provides an in-depth account of the financial 'bubble' but further analysis is needed to determine what political decisions are required in the future.

1.3 The EESC generally endorses the Group's 31 recommendations but would like to widen the focus of the analysis and make a number of comments and additions.

1.3.1 The de Larosière Group recommends introducing higher capital requirements for banks in 'good times' and lower requirements in 'bad times'. In view of the difficulty of forecasting fluctuations in the economic cycle, this might be a risky proposal. At the same time, the example of Spain shows that a system based on variable capital requirements can work. Therefore the EESC believes that such a measure needs to be studied with regard to timing before it can be implemented.

1.3.2 The EESC thinks that higher capital requirements and greater transparency for off-balance sheet operations are absolutely essential. The Spanish authorities had the most stringent rules governing off-balance sheet items and the Spanish banks were the least affected by the crisis.

1.3.3 'Off-balance sheet items' and 'Special purpose vehicles' have sometimes been abused. Risky assets have been removed from banks' balance sheets in order to avoid capital requirements and sometimes in order to avoid taxation. Against this background, the EESC thinks that stricter rules are required.

1.3.4 The EESC believes that making the riskiness of bank assets more transparent ought to be one of the main demands in the follow-up to the report. The EESC, like the Group, thinks that banks and financial institutions should always retain a part of the underlying risk on their books when risky assets are sold on. The risks inherent in financial products must be clearly evident. Transparency of financial products is necessary in order to restore confidence in the financial markets. Here the EESC would again refer to the case of Spain. New instruments should not be used in the financial markets before they have been vetted by a monetary authority. The introduction of such checks should be discussed. It has to be decided whether they should be national checks or whether a common EU-wide system is required. The degree to which financial activities are cross-border in nature argues in favour of a common system.

1.3.5 The ‘parallel banking system’ consists of various forms of unregulated lending. These new forms of financial activity have been able to develop outside the scope of regulation, not even being subject to reserve requirements. The EESC agrees that they should also be brought within the ambit of regulation. The report also calls for common rules for investment funds, definitions of the various products used and stricter supervisory control. It is easy to concur with these recommendations.

1.3.6 Stricter requirements concerning bank management and auditing are essential. The EESC does not believe that the solutions put forward by the de Larosière Group pay enough attention to the role of auditors. With effective auditing it would have been possible to reduce the spread of risky instruments. Management of financial firms must be able to rely on auditing in the valuation of assets. The role of auditors and accounting methods should be included in the revision of Basel II.

1.3.7 The report makes good recommendations on bonus schemes. They should be set in a multi-year framework and reflect actual performance rather than just being guaranteed in advance. The EESC believes that there is need for a transition from a short-term to a long-term horizon, with bonuses not linked to speculative activities. In this spirit, the EESC supports the idea of a tax on financial transactions, the proceeds from which could be allocated to development aid. Moreover, an additional requirement is that bonuses should not be based on general developments but on whether the bank manages to turn in a performance which is better than the overall trend. It would also be good to establish a ceiling for bonuses in order to avoid excesses and ill-considered risk-taking. An ‘exit strategy’ for the financial crisis should provide for repayment of the vast sums disbursed to financial institutions from government budgets rather than reverting to high profits and bonuses.

1.4 Supervision of financial markets was the main task entrusted to the de Larosière Group. The EESC also thinks that supervision is key to preventing the occurrence of another financial crisis. But supervision requires rules. Therefore the proposals for amending and strengthening rules set out in the first part of the de Larosière report are considered equally important.

1.4.1 The de Larosière Group notes that there is a need for a European body to carry out macro-prudential supervision of the financial system and issue macro-prudential risk warnings. It recommends that the ECB/ESCB be given this responsibility and that a special council be entrusted with this task. Whilst linking the council administratively link to the ECB makes sense *per se*, it is the ESCB which must be formally responsible for conducting supervision. Supervision must definitely cover financial systems in all of the Member States and the ESCH must also appoint the senior management of the new council/board.

1.4.2 The report recommends that the new system of micro-prudential supervision be created in two phases, with different authorities for the supervision of banks, investment funds and securities markets. The second phase would consist of establishing common ground rules for supervision and eliminating differences in national application. During this phase, sanction regimes would also be harmonised. The EESC sees no reason to delay this process and therefore welcomes the fact that in its communication the Commission now recommends that immediate steps be taken to prepare the whole system for micro-level supervision.

1.4.3 The EESC believes that colleges made up of supervisors from the relevant national supervisory authorities could be difficult to manage unless accompanied by the necessary harmonisation. Otherwise differences in the rules governing national supervisory authorities would make it necessary in practice for the three new authorities to assume responsibility for part of the supervision of cross-border financial firms.

1.4.4 The boards of the three new authorities should not be composed of only bankers. Trade union organisations, consumers of bank services as well as the EESC, as the representative of civil society, should also be given places on the boards.

1.5 The de Larosière Group feels there is a need at global level to beef up the Basel II framework, international accounting standards and global regulation of credit rating agencies and derivatives markets, to introduce new governance practices in the financial sector and to give the IMF a stronger role. The Group would like to put an end to the possibility whereby financial firms are attracted to a particular jurisdiction because of weak regulation of the financial sector. Several of the Group’s recommendations were, however, already adopted at the G-20 summit in London. The Financial Stability Forum set up in 1999 to promote global financial stability was transformed into the Financial Stability Board. The EESC hopes that this body will become more transparent and be endowed with adequate resources, knowledge and the power to act. The EESC welcomes the fact that the IMF will be given more resources to help countries facing acute problems but would criticise the demands laid down by the IMF, which bring into question important aspects of the European social model. It is all the more reason why it is essential for the EU to speak with a single voice within the IMF.

1.5.1 In discussions on financial markets use is now made of the term ‘stress test’ – an examination of how a country’s banking system would cope in the event of a financial market crisis. Viewed against the background of the current financial crisis, it is easy to understand how important such tests could be. At the same time this raises the crucial question as to whether the results should be made public. If the IMF were to publish the results of such a test showing that the banking system in a particular country would not be able to survive a crisis, the crisis could then become a reality.

2. **Introduction**

2.1 The extent of the current financial and economic crisis is unprecedented in peacetime. The Depression of the 1930s took place at a time when the world's economies were not as integrated as they are now. It was mainly the US and Europe which were hit. What we are experiencing today is, to a large degree, a global crisis.

2.2 What started as a financial crisis has turned into an economic crisis accompanied by recession in large parts of the world. It is likely to be followed by a social crisis with high unemployment. How extensive it becomes will be determined by what kind of policy is adopted to address the crisis. It has been accompanied by a political crisis which has led to the fall of governments.

2.3 However, the present opinion focuses exclusively on the financial crisis and what can be done to prevent it recurring in the future. Seen against the background of the overall crisis, the subject matter is limited: it does not deal with the economic crisis or with measures for countering the current financial crisis, such as providing the financial sector with public funds. Rather, it is simply about the future and in particular the supervision of the financial sector.

2.4 This was the brief entrusted to the de Larosière Group, whose report is the subject of the present EESC opinion. The de Larosière Group saw fit to widen its brief. This was necessary in order to provide a comprehensive picture enabling more constructive proposals to be put forward.

2.5 The current crisis started in the financial sector. Before the de Larosière Group had published its report, the crisis had assumed such serious proportions that the European Commission had already put forward proposals for changes to EU legislation. The most important of these is probably the proposal on credit rating agencies. A proposal has been put forward for a directive on particular forms of financial activity. A communication presented on 27 May discusses the section of the de Larosière report dealing with supervision of the financial sector. According to Annex 1 of the Commission staff working document accompanying the Commission communication, there are five differences between the de Larosière report and the communication. These differences are commented on briefly in points 6.2.4, 6.3.1 and 6.3.5. The EESC will deliver a separate opinion on the forthcoming practical legislative proposals. Although the Commission does not touch upon the other parts of the de Larosière report in the communication, the EESC believes that they are also of the utmost importance for the future of the financial sector.

2.6 The de Larosière report was written by bankers for bankers and those who will have to take the proposals on board are primarily banking experts in the Commission and finance ministers in the Member States. The EESC supports the Group's 31 recommendations but the focus must be widened. Those who, in practice, brought about the financial crisis cannot solely be responsible for solving the current problems. Consumers of financial services are private individuals and firms who deposit their savings and borrow to finance their investments. The task of the financial markets is to serve these groups, i.e. civil society, in the best possible way. So, whilst generally endorsing the report, we would like to make some comments on it and put forward some additional proposals.

3. **Causes of the financial crisis**

3.1 Excess liquidity in the financial sector did not prompt any measures by central banks. The focus was exclusively on the level of prices, and this did not justify raising interest rates. The availability of cheap liquidity led to a rise in security prices. Just as there can be no doubt that the level of liquidity was too high when the crisis started, so a consequence of the crisis is that it has now fallen to a level which is too low. On the other hand, it is difficult to say what is an adequate level of liquidity and money supply under normal circumstances. The EESC would also highlight the dilemma of simultaneously using inflation and some measure of money supply as monetary policy indicators. An excessive money supply should lead central banks to raise interest rates. If, at the same time, inflation is low, this should, on the contrary, lead to a fall in interest rates. The EESC therefore believes that if, even in such complex situations, the money supply is used as an indicator, the potential effects on the real economy must be taken into consideration.

3.2 Political decisions supporting home ownership regardless of people's ability to pay, the low cost of borrowing and new products created by financial institutions by bundling up different securities had the effect of concealing the underlying risky loans (subprimes). These securities spread throughout the world's financial markets as private saving in the US was even negative in the period 2005-2006. The EESC commented on this in July 2008 [1] as follows: 'The recent sub-prime mortgage crisis in the United States has revealed how the volatility of property prices combined with poor client-risk assessment practices with respect to non-payment of instalments that are out of proportion with the actual value of the mortgaged property itself, can generate a financial crisis serious enough to destabilise the entire system. For this reason, any EU action should draw on this experience …'

3.3 At the same time, imbalances in world trade led to the emergence of large surpluses in some countries (above all China), which were used to buy US Treasury bonds. New, complex combinations of securities (including subprimes) yielded high returns and the whole financial market searched for ever-higher returns. The additional securities served as a basis for new lending so that the volume of financial transactions expanded – an expansion which was based on securities which were more risky. The understanding was that one of the purposes of the new, complex financial products was to spread risks. The increase in the volume of transactions on financial markets created the impression of ever-increasing profits.

[1] OJ C 27, 3.2.2009, p. 18.

3.4 Risky mortgage-backed assets, which were difficult to sell in the banking system, were incorporated into new securities (through securitisation), which made it possible to sell them on. This practice was brought to an end and the crisis triggered when the United States entered recession in 2008 and unemployment climbed. Many homeowners could not afford to pay the new interest rates. Banks had to mark down the value of their securities and sell them. The value of the assets underlying these securities fell further and the downward slide accelerated. Confidence collapsed.

3.5 The de Larosière report mentions several factors which contributed to the sequence of events described above:

— when the process started the regulation of international banking took place within the framework of the Basel 1 Accord. In fact, this framework encouraged financial firms to push risk taking off their balance sheets. This has been partly remedied by the Basel 2 framework;

— the explosion of new, complex financial products which were traded 'over the counter', whereby the associated risks became invisible;

— regulation of financial institutions' activities is based on risk assessment carried out through credit rating agencies;

— credit rating agencies gave the same rating to these virtually worthless financial assets as they did to government bonds. The agencies are funded by the very financial establishments whose products they rate;

— boards and senior managements of financial institutions did not understand the nature of the risks involved in the new, highly complex financial products;

— inadequate regulation and supervision, without coordination, coupled with strong competition between financial centres.

3.6 Implicit in the de Larosière report is the criticism that central banks did not take measures to deal with the dramatic increase in liquidity.

3.7 However, the EESC would like to take the analysis a few steps further. Rising liquidity was partly due to imbalances in the world economy. This is most clearly evident in relations between the US and China: a trade surplus in China and a saving ratio equivalent to 30-40 percent of income, as a buffer against illness and old age; a trade deficit in the US associated with non-existent saving. Another possible explanation, which is not touched upon by the de Larosière Group, is the shift in income distribution away from labour income to capital income. The distribution of income has become more uneven. Both the ILO and the OECD have stated that this trend must be stopped.

3.8 The wealthiest needed to find an investment outlet for their increased assets. As the opportunities for real investment had not grown at the same pace, this put upward pressure on security prices. A new regulatory framework for financial markets cannot solve these causes of the current problems, as political decisions are needed to address them. The de Larosière report provides an in-depth account of the financial 'bubble' but further analysis is also needed to determine what political decisions are required in the future.

3.9 The financial context described undeniably encouraged the proliferation of speculative deals that bore little relation to developments in the real economy, with no use being made of international fiscal and monetary policy instruments that could have reined in their growth. The financial institutions and international bodies ignored the many social movements that have repeatedly called for regulatory measures to be adopted, one of the most important of which is the Tobin Tax.

4. **Policy and regulation**

4.1 According to the report, the present crisis is due to market failures, global imbalances, poor regulation and weak supervision. Not all these problems can be resolved by regulation but effective regulation is a precondition. The report goes on to state that all these problems must be addressed but it is questionable whether the proposed regulation goes far enough. Moreover, it could be argued that there is a danger that more regulation could reduce financial innovation. Here the EESC would recall that subprime loans and securitisation are just such financial innovations. Abuse of some of these innovations is at the root of the current financial problems. Regulation can sometimes also contribute to financial innovation, such as the SEPA (Single European Payments Area).

4.2 The Group recommends better coordination between central banks and the political bodies responsible for supervising financial markets. Central banks must devote more time to macroeconomic considerations in the form of better supervision of financial markets. The EESC believes that this recommendation and the requirement that the IMF play a more effective role in surveillance are necessary proposals.

4.3 The report states that public regulation and self-regulation in the financial sector must complement each other. As internal control has not worked, it is asserted that there is a need to oversee self-regulation. This effectively eliminates the boundary between public regulation and self-regulation.

4.4 In reality, there is no such boundary. In practice, the banking sector lays down rules for self-regulation of the financial sector through the Basel 1 and 2 frameworks. It is up to banks and other financial institutions themselves, or the state in cases where the rules are introduced by law, to ensure compliance with the rules. (Basel II entered into force in the EU on 1 January 2008 and will only become applicable in the US on 1 April 2010.) The report does not give serious consideration to the organisational and democratic deficiencies in financial markets which self-regulation gives rise to. Given a globalised market, a key question should be: do political bodies have enough influence?

5. Recommendations of the de Larosière Group

5.1 *Banks' minimum capital requirements should be gradually increased*. In view of fact that the banking crisis has created a situation where there is currently a credit shortage, such an increase should be postponed until later. The EESC believes that this is an essential requirement so as to avoid the need in the future for society to inject capital into banks when they experience liquidity problems. The EESC agrees that *the EU should adopt common definitions of capital requirements*.

5.2 *Varying capital requirements over the economic cycle*. The report argues that central banks should not only look at inflation but also at overall monetary and credit developments. When money or credit grow excessively, they should therefore be ready to tighten monetary policy. To meet these counter-cyclical objectives, it is proposed that higher capital requirements be introduced for banks in 'good times' and lower requirements in 'bad times'. Considering the difficulty of making economic forecasts, this might be a risky proposal. Raising the requirements following a period of good times and credit expansion may, instead, exacerbate a cyclical downturn if the good times are coming to end. At the same time, the example of Spain shows that a system based on variable capital requirements can work. The EESC believes that the risks associated with timing need to be examined before it can be implemented.

5.3 *Stricter rules governing off-balance sheet items in the form of higher capital requirements and greater transparency*. The Spanish authorities had the most stringent rules governing off-balance sheet items and the Spanish banks were the least affected by the crisis.

5.3.1 When banks undertake off-balance sheet operations they do so in most cases by making use of one of the financial innovations, namely 'special purpose vehicles'. Here the purpose is often to remove risky assets from the bank's balance sheet so that the bank itself is not exposed to risk. Another reason may be to avoid taxes. Bearing in mind the way in which these instruments have been abused, the EESC believes there is a need for stricter rules both with regard to off-balance sheet items and special purpose vehicles. Essential from the point of view of regulation is that banks and financial firms must not be able to use these methods to conceal their activities.

5.4 *The riskiness of bank assets must be made more transparent*. The EESC believes this ought to be one of the main demands when, in its follow-up to the report, the Commission hopefully sets out measures for achieving real transparency for bank assets.

5.4.1 The report discusses securitisation, derivatives markets, investment funds and the 'parallel banking system'. The EESC would like to see a comprehensive solution where no problem associated with these risky securities is left unresolved outside the scope of individual proposals. The parallel banking system consists of various forms of unregulated lending. The report recommends that the Basel 2 framework be extended to cover these activities (hedge funds, investment banks, etc.). This seems self-evident and a decision to this effect should be taken immediately. These new forms of financial activity, which often take place alongside the banking system, have been able to develop outside the scope of regulation, not even being subject to reserve requirements. The report also calls for common rules for investment funds, definitions of the various products used and stricter supervisory control. It is easy to concur with these recommendations. Banks and financial institutions should always retain a part of the underlying risk on their books when risky assets are sold on.

5.5 On 13 May 2009 the Commission presented a proposal for Directive on Alternative Investment Fund Mangers which covers many of these new instruments. The EESC will deliver an opinion on this proposal in due course. Earlier, in 2006, the EESC issued an opinion on the Green Paper on investment funds ([1]).

5.6 As regards accounting rules, the Group recommends that the International Accounting Standard Board (IASB) introduce new rules for the new, complex financial products. Application of the mark-to-market accounting method has severely exacerbated the crisis. When asset prices collapsed they were booked at daily value. In this difficult situation, this had the effect of depressing asset values far below their intrinsic value. Nor can the alternative method – to value assets on the basis of the original purchase price – work effectively in such circumstances. The EESC believes that this is an area where there is certainly room for innovation.

([1]) OJ C 110, 9.5.2006, p. 19.

5.7 It is worth asking the following question: what sense does it make that assets which have concealed risk are traded around the banking system? There is a perhaps a need here to do away with some of these instruments. Bankers often speak about the importance of financial innovation. Has this process been taken too far? The EESC calls on the Commission to go through the existing instruments, to establish their usefulness and the risks they carry, and to propose which ones might be discarded or to give definitions of those which are to remain. The banking world cannot take sole responsibility for this task. The Commission must prepare the ground for relevant decisions of the European Parliament and the Council. Financial products must not be made unnecessarily complex. It must be clear what risks they contain. Transparency of financial products is perhaps the key requirement for restoring confidence to the financial markets.

5.7.1 Here again the EESC would refer to the case of Spain. New instruments should not be used in the financial markets before they have been vetted by a monetary authority. In its review the Commission should examine the differences between the instruments used in Spain and in other EU Member States. In addition, the introduction of such checks should be discussed and a decision taken as to whether they should be national checks or whether a common EU-wide system is required. The degree to which financial activities are cross-border in nature argues in favour of a common system.

5.8 The EESC agrees with the Group's recommendation concerning banks' internal risk management that this must be an independent function, that the associated work be given a very high rank within the hierarchy and that there should not be over-reliance on external assessments (credit rating agencies). The recommendation to develop crisis management arrangements within financial institutions can, of course, be endorsed. The crucial question here is whether recommendations on this subject can ever be anything more than just that. To what extent is it possible to regulate a financial institution's internal practices? Probably all that can be done in this area is that supervisory authorities oversee the organisations concerned and publish their criticisms.

5.9 When the crisis became acute, many Member States strengthened EU requirements regarding bank deposit guarantees. In the report the Group calls for harmonisation of the rules governing deposit guarantee schemes so that all bank customers receive a level of protection which is equal and suitably high. A solution must be found to the problem of bank branches in other countries but where is the funding for these bank deposit guarantees to come from? The EESC agrees with the Commission on this issue and calls upon it to quickly put forward a proposal on new EU rules on bank deposit guarantees.

5.10 *Stricter requirements concerning bank management and auditing*. In the light of what has happened this is an essential demand. Financial institutions also have ethical codes but in certain cases it appears that they have not had any impact on actual behaviour. It is difficult, however, to come up with practical proposals where personal competence is concerned. With new rules and the possible exclusion of some instruments from the market, the management of banks should become easier. Instruments whose purpose is to conceal risk make the management of banks very difficult. Moreover, the EESC does not believe that the solutions put forward by the de Larosière Group pay enough attention to the role of auditors. With effective auditing it would have been possible to reduce the spread of risky instruments. Management of financial firms must be able to rely on auditing in the valuation of assets. The role of auditors and accounting methods should be included in the revision of Basel II. It would also be extremely useful to involve some stakeholders in assessing the policies and instruments produced by the financial bodies, by setting up ad hoc committees.

5.10.1 A bonus scheme which rewards investment in short-term, risky assets is a major factor shaping the behaviour of bank management. The report makes good recommendations on bonus schemes, namely that assessment of bonuses should be set in a multi-year framework and reflect actual performance rather than just being guaranteed in advance. The EESC believes that there is need for a transition from a short-term to a long-term horizon, with bonuses not linked to speculative activities. In this spirit, the EESC supports the idea of a tax on financial transactions, the proceeds from which could be allocated to development aid. An additional requirement is that bonuses should not be based on general developments but on whether the bank manages to turn in a performance which is better than the overall trend. It would also be good to establish a ceiling for bonuses in order to avoid excesses and ill-considered risk-taking.

5.11 As regards *credit rating agencies*, the Group recommends that the Committee of European Securities Regulators should be entrusted with the task of licensing these bodies. The Commission has already presented a proposal on a Regulation on credit rating agencies. The EESC has drawn up an opinion on the proposal in which it endorses the Commission proposal [1]. The Group argues that there is a need to review the arrangements for funding credit rating agencies. The EESC believes that it can already be stated categorically that they should not be financed by those whose credit instruments are rated by credit rating agencies.

6. **Supervision**

6.1 Supervision of financial markets was the main task entrusted to the de Larosière Group. The EESC also thinks that supervision is key to preventing the occurrence of another financial crisis. But supervision requires rules. Therefore the proposals for amending and strengthening rules set out in the first part of the de Larosière report are considered equally important.

[1] OJ C 277, 17.11.2009 (ECO/243 – credit rating agencies).

6.2 *A European system for supervision at macro-level*

6.2.1 The report criticises the present supervisory arrangements for placing too much emphasis on the supervision of individual firms and recommends, instead, that supervision should encompass the entire financial system. It recommends that the ECB/ESCB (European System of Central Banks) be charged with this responsibility. Where cross-border supervision is necessary (for financial institutions with branches in other countries), the Group considers that a binding mediation mechanism is required.

6.2.2 The de Larosière Group notes that there is a need to formally charge a European body with the task of macro-prudential supervision of the financial system and of issuing macro-prudential risk warnings where required. An independent council/board (European System Risk Board should be set up within the ECB/ESCB and entrusted with this task. In addition to the central banks, the council would comprise representatives from the three authorities it is proposed should be responsible for micro-prudential supervision. The EESC would note that, at present, there probably does not exist any body with the knowledge necessary for macro-prudential supervision. Therefore such knowledge needs to be built up as support for the council. The Larosière report also makes the point that the Commission should be called in where overarching risks arise in the financial system.

6.2.3 The EESC endorses ECOFIN'S and the European Council's additions to the Commission's proposal in the communication of 27 May, according to which the ECB General Council should be represented on the European Systemic Risk Council (ESRC), with national supervisory authorities as observers, every country should have a vote and any recommendations from the ESRC should be made through the ECOFIN Council. The European Council has also proposed that the chairperson of the ESRC be chosen by the ECB General Council. The EESC thinks that this is appropriate given that all 27 Member States are represented on this body. The European Council recommends that the new European Supervisory Authorities should also have supervisory powers for credit rating agencies. The EESC supports this proposal, which is the outcome of the discussions on the proposal for a directive on credit rating agencies, but points out that only one of these three authorities should have this task.

6.3 *A European system of micro-prudential supervision*

6.3.1 As regards day-to-day supervision, the Group recommends strengthening the three level 3 committees for the supervision of banks, insurance companies and securities markets by transforming them into authorities. Regulation within these three areas is so different as to rule out the possibility of merging them into one authority.

6.3.2 It is proposed that only the financial sector be represented on these new authorities. As already noted, the EESC feels that financial activity is not only an issue for those directly involved in such activity. A strong case can be made for participation by employee organisations. Equally, there are strong grounds for giving consumers of banking, insurance and securities services places on these authorities. Here a comparison can be drawn with the proposal put forward by the Obama administration in the United States, where it is planned to set up a separate agency for bank customers to monitor financial activity. It goes without saying that the EESC, as the representative of civil society, should be invited to take part as well.

6.3.3 It is recommended that these new authorities be, inter alia, given the task of establishing *differences among Member States in the application* of current EU rules. The EESC believes therefore that it follows naturally from this recommendation that the Commission propose amendments to the rules with the aim of eliminating such differences.

6.3.4 The Group states in the report that there must be *competent supervisory authorities* in all Member States, which should also be equipped with deterrent regimes. The EESC can only agree with this recommendation and would also point out how important it is that these authorities be independent of banks and financial institutions. The Commission is called upon to propose EU rules in this regard.

6.3.5 The de Larosière Group recommends that national supervisory authorities continue to carry out day-to-day supervision but that the three new authorities be responsible for setting standards and coordinating activities. Checks must be made to determine whether the national authorities really are independent. In the case of cross-border financial firms, colleges of supervisors from the relevant national supervisory authorities would be set up. In the light of experience so far, national authorities should be obliged to exchange information.

6.3.6 The report recommends that the new system of micro-prudential supervision be created in two phases. The second phase would consist of establishing common ground rules for supervision and eliminating differences in national application. During this phase, sanction regimes would also be harmonised. The EESC sees no reason to delay this process and therefore welcomes the fact that in the communication the Commission now recommends that immediate steps be taken to prepare the whole system for micro-level supervision.

6.3.6.1 The EESC believes that colleges made up of supervisors from the relevant national supervisory authorities could be difficult to manage unless accompanied by the necessary harmonisation. Owing to fundamental differences in the rules governing national supervisory authorities, the three new authorities would, in practice, have to assume responsibility for part of the supervision of cross-border financial firms.

6.3.6.2 The EESC fully supports the European Council invitation to the European Commission to specify how the European System of Financial Supervisors could play a strong coordinating role among supervisors in crisis situations, while fully respecting the responsibilities of national authorities in relation to potential fiscal consequences and fully respecting central banks' responsibilities, in particular relating to the provision of emergency liquidity assistance.

7. **Remedies at global level**

7.1 The de Larosière Group also feels there is a need at global level to address regulation of the financial sector, supervision and crisis management and that an appropriate framework for this purpose is lacking. The Group calls for a strengthening of the Basel II framework and international accounting standards, for global regulation of credit rating agencies, for new governance practices in the financial sector and for a stronger role for the IMF. It would like to put an end to the possibility whereby financial firms are attracted to a particular jurisdiction because of weak regulation of the financial sector. Colleges of bank supervisors are particularly important for banks which operate globally.

7.2 Bringing about changes at global level can be expected to be difficult. Several of the Group's recommendations were, however, already addressed at the G-20 summit in London. The Financial Stability Forum, set up in 1999, was transformed into the Financial Stability Board, with an increased membership comprising all the G-20 countries plus Spain and the European Commission, a wider remit and closer links to the IMF. These changes are fully in line with the de Larosière Group's recommendation. During the current crisis, the Forum has not, to date, been capable of giving early warnings of the risks existing in the financial system. The EESC expresses the hope that the changes will make this body more transparent and that it be endowed with increased resources, knowledge and the power to act. It also needs to be stressed that the majority of the decisions made in London have yet to be implemented.

7.3 In discussions on financial markets use is now made of the term 'stress test' – an examination of how a country's banking system would cope in the event of a financial market crisis. Viewed against the background of the current financial crisis, it is easy to understand how important such tests could be. At the same time this raises the crucial question as to whether the results should be made public. If the IMF were to publish the results of such a test showing that the banking system in a particular country would not be able to survive a crisis, the crisis would then become a reality. Nevertheless, such tests should be as transparent as possible and could become a key instrument for supervision of national financial systems.

7.4 The London summit also took on board the recommendation to give the IMF more resources to help countries facing acute problems. The EESC welcomes this but would criticise the demands laid down by the IMF, which bring into question social issues which are important components of the European social model. It provides all the more reason why it is essential for the EU to speak with a single voice within the IMF.

Brussels, 30 September 2009.

The President
of the European Economic and Social Committee
Mario SEPI

Appendix

to the Opinion of the European Economic and Social Committee

The following amendments, which were supported by at least a quarter of the votes cast, were defeated in the course of the debate (Rule 54(3) of the Rules of Procedure):

Point 1.2

Amend as follows:

'The primary cause of the crisis was excess liquidity, which, according to the de Larosière Group, was due, in part, to imbalances in the world economy, most clearly so in relations between the US and China. ~~The EESC believes that another conceivable explanation is that there has been a shift in income distribution away from labour income to capital income. The distribution of income has become more uneven. The wealthiest needed to find an investment outlet for their increased assets. As the opportunities for real investment had not grown at the same pace, this put upward pressure on security prices.~~ The de Larosière report provides an in-depth account of the financial "bubble" but further analysis is needed to determine what political decisions are required in the future.'

Reason

As the rapporteur states elsewhere in the opinion, and in line with the de Larosière report itself, there are a number of factors underpinning the crisis, but there is no proof that a shift in income distribution was one of them. No study of the causes of the crisis suggests such a link.

Results of the voting

For: 68 Against: 121 Abstentions: 15

Point 1.3.3

Amend as follows:

' "Off-balance sheet items" and "Special purpose vehicles" have sometimes been abused. Risky assets have been removed from banks' balance sheets in order to avoid capital requirements~~ and sometimes in order to avoid taxation~~. Against this background, the EESC thinks that stricter rules are required.'

Reason

As the rapporteur rightly points out, the main reason for off-balance sheet items is to save own resources. There is no proof that this is done to avoid taxation, which would furthermore be extremely difficult, even if done 'off-balance sheet'.

Results of voting

For: 65 Against: 125 Abstentions: 12

Point 1.4.4

Delete point:

'~~The boards of the three new authorities should not be composed of only bankers. Trade union organisations, consumers of bank services as well as the EESC, as the representative of civil society, should also be given places on the boards.~~'

Reason

The boards are not composed only of bankers; representatives of the financial authorities are also involved. Nor is there any reason to give places to new members, as this would hamper the new authorities' work. Recommendation 12 of the de Larosière report clearly states that the senior board members of the new authorities should be independent professionals.

Results of voting

For: 60 Against: 132 Abstentions: 8.