*Office of the Director General*
*Dnr: 09-2126-600*

*Financial Stability Department*
*Dnr: 2009-385-AFS*

# Response by Finansinspektionen and Sveriges Riksbank to the Consultation on the future of financial services supervision in the EU

This is a joint response by Finansinspektionen (the Swedish Financial Supervisory Authority) and Sveriges Riksbank, hereinafter the "Swedish authorities", to the Commission's consultation on the future of financial services supervision in the EU.

## General remarks

The present crisis has painfully revealed many of the underlying structural weaknesses of the current regulatory and supervisory arrangements in EU. In the view of the Swedish authorities the de Larosière report constitutes a comprehensive and pragmatic proposal to address these weaknesses.

The Swedish authorities welcome the idea to take EU supervision one step forward by establishing certain supervisory functions at EU-level, as a complement to national supervision. In particular, we support the proposals to strengthen macroprudential supervision at EU-level and to reinforce the mechanisms for coordination and harmonisation of micro-prudential supervision, i.a. through the establishment of independent EU micro prudential authorities. Furthermore, we firmly support the de Larosière reports strong emphasise on the need to achieve a close and consistent link between supervision and crisis management. It is of fundamental importance that both these issues are addressed in comprehensive manner.

Below follows the Swedish authorities' views on selected issues of the de Larosière report, mainly focusing on the supervisory and crisis management arrangements. Refraining from commenting on other parts of the report does not necessarily imply that the Swedish authorities concur with the recommendations in these parts.

## Supervisory arrangements

### *Macro prudential supervision*

Agreeing to the need of establishing macro prudential supervision at EU-level the Swedish authorities consider the tasks suggested for the ESRC to be appropriate; performing macro-prudential analyses, issuing risk warnings and giving recommendations on policy measures. With regard to the scope of analysis the macro prudential body should have a broad mandate, allowing them to undertake analyses and issue warnings in all areas potentially giving raise to financial stability concerns (without prejudice to article 108 of the Treaty of the European Union).

A critical question will be to find appropriate mechanisms 1) to ensure that precise and independent analyses and risk warnings could be prepared, and 2) that warnings could be transformed into effective policy responses. Particularly complicating is the fact that warnings and recommendations will be decided at EU-level, by the ESRC, while correcting measures will have to be implemented (mostly) at national level. To be able to perform sharp analyses, warning and recommendations on basis of an EU-wide mandate the ESRC needs be sufficiently independent and equipped with an explicit mandate, as well as an appropriate decision making structure. To facilitate swift and effective implementation of ESRC recommendations a 'comply or explain' mechanism seems desirable. To further strengthen the compliance mechanism the work of ESRC should be subject to a high degree of transparency, preferably by public disclosure of analyses and recommendations.

Concerning the institutional arrangements the Swedish authorities support that the macroprudential body is placed closely to the ECB. However, setting up a supervisory body under the auspice of ECB needs careful consideration on number of aspects; 1) how to safeguard the equal influence of euro vis-à-vis non-euro countries; 2) how to ensure that relevant micro prudential considerations are included in macroprudential assessments (and vice versa) and; 3) how to keep the macroprudential supervision on arms-lengths distance from ECB's regular tasks and avoiding conflicts of interests with the ECB's monetary policy operations.

For these purposes, the Swedish authorities take the following positions on institutional arrangements of the ESRC;

- The ESRC must be a separate entity governed by ECBS. Macro prudential supervision in the EU cannot be the exclusive competence of the euro countries.
- In order to maintain an independent status of the ESRC in relation to the ECB's regular tasks and to ensure an equitable position of non-euro members we would support to have separate chairs in the ESRC and the ECB governing council.
- To ensure that the tasks of the ESRC can be fulfilled and appropriate risks can be identified, the decision-making mechanisms of the ESRC need to be sufficiently clear and efficient. For the same reason the management of the ESRC secretariat needs to be sufficiently competent and independent from other ECB activities.
- The ESRC secretariat should have an explicit mandate to present clear and concrete analyses and risk warnings for decision in the ESRC, even if controversial or directed at pointing out problems or weaknesses in individual members states. In order to build confidence in the ESRC, public transparency in these matters is important.
- The ESRC should not only issue "warnings", leaving to the supervisors, national central banks or governments to do all the necessary cost-benefit analysis of weather to intervene or not. The ESRC should communicate at least a tentative

view on the relative importance of certain risk and the trade-offs involved in supervisory action or any other kind of policy response.

- National micro prudential supervisors should have permanent representation in the ESRC.
- In order to establish the necessary link between the macro prudential and micro prudential supervision, and to avoid overlaps in supervisory work (e.g. collecting information) appropriate mechanism for co-operation must be established. Preferably, information should be gathered by the micro prudential authorities (from national supervisors) and shared to the ESRC on a regular basis. If the ESRC would need information beyond what is regularly reported to them, a request should be submitted to the micro prudential authorities and not directly to national supervisors.

***Micro prudential supervision***

Considering the need for strengthening co-ordination and coherence in EU-supervision the Swedish authorities supports the proposal to transform the level 3-committees to authorities and to assign them with a broader spectrum of tasks, including both supervisory and regulatory powers. But co-ordination is not enough - it is also important, as is pointed out in the report, to align resources, competence and powers between national supervisors, implying both higher and more even quality in the supervisory work. Moreover, additional resources must be set aside for the huge amount of co-ordination work that will take place during the next few years; the necessary co-ordination work must not be accomplished at the expense of actual supervision.

In relation to the individual tasks proposed for the authorities the Swedish authorities have the following views:

- A binding mediation mechanism in case of disputes between national supervisors is welcome, but should only be used when all other options to reach agreements are exhausted. The same reasoning applies for the designation of group supervisor.
- As part of their mandate to develop harmonised supervisory practices and perform peer reviews the authorities should be entitled to take part in on-sites inspection, but only in capacity of observers and without direct influence over the supervisory process.
- A mechanism for discrimination complaints is welcome. It is however important that such mechanisms work both ways, enabling also cross-border institution to file complaints against supervisory discrimination vis-à-vis other institutions.
- Full supervision at EU-level of business activities that by nature have a functional scope extending beyond national borders, e.g. credit rating agencies and EU-wide infrastructure institutions, is a welcome step.
- In the area of regulation and supervisory standards the Swedish authorities support the proposals to introduce a mechanism for making the interpretation decisions taken by the authorities legally binding throughout the EU. We also

support that the authorities would be responsible for defining common supervisory practices and arrangements for the functioning of colleges.

- A strengthened supervisory peer review mechanism is crucial and strongly supported by the Swedish authorities. The modalities of such mechanism need to be considered closely in order to ensure objective and sincere reviews. We agree that reviews should be linked to a graduated and effective sanctioning regime, but note that a mechanism for temporary acquisition of duties would represent a major curtailment of the powers of national authorities. Any such arrangements must be carefully assessed and, if introduced, accompanied by strong safeguards to protect the interest of the concerned member state.
- Binding procedures for cooperation and information sharing between the micro prudential authorities and the ESRC is an absolute requirement for an effective supervision at EU-level. Such procedures must be developed with a view to avoid unnecessary overlaps in work, particularly with regard to information gathering. Both the authorities and the ESRC should as far as possible rely on the information collected by national authorities, on basis of a harmonised supervisory reporting format defined by national authorities, the ESRC and the EU authorities in close collaboration. As proposed above, all information to ESRC should be channelled via the EU micro prudential authorities, limiting the number of counterparties that national authorities will have to communicate with.
- It is desirable that the authorities play a coordinating role in cross-border crises. However, the role of authorities in relation to implementation of measures should be limited to giving advice and recommendations.

With regard to the number of micro prudential authorities the Swedish authorities believe that supervisions could be carried out more efficiently if not divided into three different authorities with separate sectoral responsibilities. Therefore, the long term goal should be a system with only one micro prudential authority at EU-level. In the meantime, some form of co-ordinating function for the three authorities is advisable.

In order to achieve the necessary independence and operative strength for the authorities they should be equipped with a clear mandate, well defined powers and sufficient resources. The secretariats need to be strong and decision making procedures needs to be effective. Authorities should be accountable to the council and also report to the Commission and the Parliament. Without strong governance and budgetary structures not much will be won by transforming the level 3 committees to authorities.

There are some key legal challenges that have to be solved before establishing the new supervisory bodies. The balance between the assignment of certain supervisory functions to the proposed authorities and the corresponding responsibilities at the national level must be sorted out, and there is a need to clarify the legal basis for decisions taken by the EU authorities and how their decisions can be challenged nationally. It is also important to develop organisational forms, including financing, underpinning independence and integrity.

The Swedish authorities strongly support the proposal for a harmonised set of core rules in the EU, without unjustified national discretions and options. There is need for

the Commission to speedily equip the EU financial sector with a consistent set of core rules. Without a single rule book, supervision of cross-border institutions will not succeed. Our proposal to the Commission is to present a roadmap for regulatory convergence, including definitions of e.g. capital, large exposures, supervisory powers, early interventions etc.

***Timetable***

The Swedish authorities agree with the Commission's timetable for implementation.

Crisis management and resolution arrangements

The Swedish authorities strongly support the proposals to develop a coherent and workable regulatory EU framework for crisis management, strengthening and harmonising national crisis management frameworks and removing legal obstacles to cross-border crisis management.

Such framework needs to comprehensively cover the whole crisis management process, from early intervention, management of institution with temporary liquidity and solvency problems to the winding up of financial firms. It also needs to set out a clear structure of rights and responsibilities of different stakeholders, reflecting the need to maintain financial stability and avoiding moral hazard. Particular effort should be dedicated to finding efficient arrangements for dealing with large/systemic banks and banks operating on a cross-border basis.

Furthermore, considering the close link between crisis management and supervision the framework must be developed with a view to find appropriate solutions to deal with current asymmetry of crisis management responsibilities and supervisory responsibilities in EU-regulation (the home-host issue). The division of crisis management responsibilities between member states must be clarified and more consistent with supervisory responsibilities. Mechanisms for safeguarding the interest of all member states concerned by the supervision and/or the crisis management of a particular institution must also be in place.

Major legislative changes will be needed to establish a crisis management framework that can live up to the above said. Possibly, carve outs in national legislation will be required. However, the EU should not shy away from this task. Considering recent events it is evident that major improvements are needed. Crisis management issues must remain a top priority on the regulatory agenda of the EU.

***Deposit guarantee schemes***

As part of the work on strengthening the EU crisis management framework the Swedish authorities support the proposal to further harmonise DGS-rules, particularly with regard to funding arrangements. A solid crisis management framework needs to be backed by clear and sustainable financing arrangements, and an important first step should be to firmly establish in the deposit guarantee directive that the schemes should be fully paid by the deposit taking institution and that premiums should be collected in advance and in relation to the banks individual risk profile, similar to the characteristics of an ordinary insurance scheme. Premiums should be set to match this expected cost of the deposit insurance, i.e. the expected aggregated cost that each

individual institution impose on the scheme over a defined time period (e.g. annually).[1]

Furthermore, given the size and nature of DGS liabilities, major payouts (following the failure of large institution) may induce temporary deficits even in a prefunded scheme. In the end, only governments can be expected to have the financial strength to come up with enough liquidity to cover such deficits. The Swedish authorities therefore believe that it should be explicitly stated in the directive that governments are ultimately responsible for the scheme (either directly or through a re-insurance arrangement). In addition, in the case of large cross-border branch establishments, the home and host countries should be able to agree on a reinsurance policy where the host country assumes responsibility of a specific share of the DGS liabilities, in return for a proportionate supervisory influence.

Furthermore, the Swedish authorities would welcome a harmonisation of DGS' trigger mechanisms. Currently, some member states' schemes have early intervention rights while others would not be activated until an institution actually has defaulted. This fact is likely to result in co-ordination problems among member states in the event of a crisis.

| | |
|---|---|
| Finansinspektionen | Sveriges Riksbank |
| Tomas Flodén | Mattias Persson |
| Acting Director General | Head of Department |

[1] It will not be necessary to have full coverage in a tangible fund at any given point in time. The idea is rather to assure that the premiums balances the costs on average and over time. This would require that the guarantor has unconstrained access to credit to finance temporary deficits in a "synthetic" fund. Thus, the guarantor must have sufficient financial strength, by itself or through back-up facilities, to borrow funds on reasonable terms, even when the financial system is under stress.