COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.9.2009
SEC(2009) 1235

COMMISSION STAFF WORKING DOCUMENT

accompanying document to the

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board

Proposal for a

COUNCIL DECISION

entrusting the European Central Bank with specific tasks concerning the functioning of the European Systemic Risk Board

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

establishing a European Banking Authority

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

establishing a European Insurance and Occupational Pensions Authority

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

establishing a European Securities and Markets Authority

SUMMARY OF THE IMPACT ASSESSMENT

{COM(2009) 499 final}
{COM(2009) 500 final}
{COM(2009) 501 final}
{COM(2009) 502 final}
{COM(2009) 503 final}
{SEC(2009) 1234}

1. INTRODUCTION

In its Communication "European Financial Supervision" of 27 May 2009, the European Commission proposed changes to European financial supervision in order to remedy failings revealed in the recent financial crisis. Specifically, it proposed the creation of:

- a **European Systemic Risk Council or Board (ESRB)** to assess risks to the stability of the financial system as a whole ("macro-prudential supervision"), and provide early warning of systemic risks and, where necessary, recommendations for action.

- a **European System of Financial Supervisors (ESFS)** for the supervision of individual financial institutions ("micro-prudential supervision"), consisting of a network of national financial supervisors working with three new European Supervisory Authorities (ESAs), for the banking, securities and insurance and occupational pensions sectors.

These proposals were endorsed by the European Council of 18-19 June 2009, which however also emphasised that decisions taken by the ESAs should not impinge on the fiscal responsibilities of Member States.

This Impact Assessment accompanies the proposals for legislative acts creating the ESRB and the ESFS. In order in particular to define the scope of the power to propose binding technical standards conferred on the ESAs, amendments to the relevant community legislation will shortly be introduced.

2. CONSULTATIONS AND PROCESS

The Commission conducted a public consultation on the Communication of 27 May, with a closing date of 15 July. 98 submissions were received, the great majority of them broadly supportive of the supervision proposals in the Communication. An Impact Assessment Steering Group to steer the preparation of this Impact Assessment, comprising representatives from various DGs, met twice.

3. PROBLEM DEFINITION

Building on the general problems identified in the Impact Assessment accompanying the Communication, more specific problems were identified linked to the creation of the ESRB and the ESFS.

For the ESFS these are:

- How to ensure a single set of harmonised technical rules, and consistent application of those rules.

- How to ensure the good functioning of colleges of supervisors, particularly in terms of supply of appropriate information to all members of the college.

- How to achieve agreement between home and host supervisors on matters which require agreement.

- There is a need for better co-ordination between supervisors, and coherent action, in financial emergencies.

- How to avoid impingement of Member States' fiscal responsibility, in line with the European Council conclusions, while not hindering the activity of the ESAs in areas which do not impinge on the fiscal responsibilities of Member States. This will ensure that the principle of subsidiarity is respected in the activity of the ESAs, because the area of direct fiscality is an exclusive competence of the Member States.

For the ESRB these are:

- How to make the ESRB as effective as possible, given that it cannot be given binding powers because a political decision has already been taken not to give it legal personality.

- The warnings and recommendations of the ESRB must reach the right addressees and lead to the desired action, but without having the self-fulfilling effect of helping to trigger a crisis.

- The ESRB must receive the information which it needs to carry out macro-prudential assessments effectively.

- The ESRB must have a secretariat structured and located so as to allow it to carry out its functions cost-effectively.

- Subsidiarity must be respected in the structuring and activity of the ESRB.

4. OBJECTIVES

The specific objectives identified in the Impact Assessment accompanying the Communication of 27 May are considered as the general objectives for this Impact Assessment, as the level of analysis is more detailed in this case.

A number of specific objectives are also defined, for the ESRB and the ESFS:

ESFS

a. Assume all of the tasks of the current EU Committees of Supervisors;

b. Ensure a set of common rules;

c. Ensure a consistent application of EU rules;

d. Determine how to ensure a common supervisory culture, including ensuring colleges of supervisors develop successfully and consistently;

e. Determine whether/how to grant full supervisory powers for certain institutions;

f. Determine how to co-ordinate and effectively manage crisis situations;

g. Ensure access to necessary information;

h. Define safeguards to avoid impact on Member States' fiscal responsibilities;

i. Ensure the independence of the ESAs.

ESRB

a. Establish adequate procedures to obtain information about macro-economic risks for financial stability;

b. Identify macro-prudential risks in Europe;

c. Issue warnings to the relevant actors and recommend the appropriate actions;

d. Determine how to achieve effective follow-up to warnings/recommendations;

e. Ensure the independence of the ESRB.

Furthermore, a system-wide objective is to ensure that both levels (ESRB and ESFS) work together coherently to identify and react to cross-cutting elements which impact both micro- and macro-level stability (such as remuneration policies).

5. ANALYSIS AND COMPARISON OF POLICY OPTIONS

For both the ESFS and the ESRB, options were considered in the following areas:

a. Powers and competences

For the ESFS, the areas considered under this heading were:

- *Powers to ensure a single set of harmonised rules*. Here, two types of powers are envisaged: firstly the power to propose binding technical rules for endorsement by the Commission, in areas to be defined by forthcoming modifications to sectoral legislation; secondly, powers to intervene in case of disagreement between national supervisors on matters where agreement is, for example, required regarding a cross-border group, by mediating, and adopting a binding decision if necessary.

- *Powers to bring about consistent application of EU rules*. Where a national supervisor seems to be breaching applicable rules, an ESA would be able to issue a recommendation, which could be made binding by a Commission decision in case of non-compliance. As an ultimate resort, and on the basis of directly applicable Community rules, an ESA could address a decision to a financial institution if the Commission decision were ignored by the national supervisor.

- *Ensure a common supervisory culture and consistent supervisory practices*. ESAs should continue and expand the role of the level 3 committees in this area, including training, and also contribute to the functioning of colleges of supervisors, including by defining the information to be distributed and managing a database.

- *Full supervisory powers*. It was decided to place in each Regulation creating an ESA an article making it possible to grant it direct supervisory powers for certain types of institution, but only by further modifications to sectoral legislation. For the moment, this is only envisaged for Credit Rating Agencies.

- *Powers in crisis situations*. On this point, it was considered that the ESAs should be able to adopt decisions addressed to national supervisory authorities over the full scope of relevant sectoral legislation, once the Commission has declared the existence of an emergency.

- *Powers to collect and manage micro-prudential information*. The ESAs must have access at the minimum to the information currently received by the Level 3 committees (anonymised and aggregated data). In order to carry out their functions, it would be effective and coherent for them to be able to request national supervisors to provide the information needed, on the basis of a motivated request, including information regarding individual financial institutions.

- *Safeguard for fiscal responsibilities of Member States*. Rather than have just a declaratory provision, or to allow Member States discretion as to when their fiscal responsibilities are impinged upon, it was considered appropriate for the Council to decide by QMV, when a Member State and an ESA disagree as to whether the fiscal responsibilities of the Member State concerned are at stake in an ESA decision.

For the ESRB, the areas considered under this heading were:

- Regarding *follow up to warnings and recommendations,* obligatory compliance is not possible, since a body without legal personality cannot issue binding acts, and no follow-up at all would undermine effectiveness, so a "comply or explain" obligation was considered to be the best option.

- On *access to information,* the ESRB could not issue credible warnings and recommendations without access to aggregated data, at the EU or country level. This could be channelled through the ESAs. Furthermore, allowing the ESRB to access data on individual institutions on reasoned request would also improve its effectiveness.

- Regarding *publicity of warnings and recommendations*, it was considered that systematic publicity could be counter-productive by potentially triggering crises, while publicity could on occasion be useful in case of non-compliance. Fixed criteria for publication or non-publication would be difficult to set, so it was considered best to allow the ESRB discretion as to when to publish on an ad hoc basis.

b. Organisation and structure

For the ESFS, the areas considered under this heading were:

- *Joint Steering Committee.* A joint committee with legal personality could adopt legal acts obliging coherent interventions by the three ESAs, and on conglomerates. However a joint Committee with legal personality could engender extra costs such as for a secretariat. Overall, it is considered more prudent to have a flexible joint Committee with no legal personality, pending the first review of ESFS functioning. There will be a sub-committee on conglomerates.

- *Voting procedure.* It was considered that a simple majority of voting Board members would be the most effective option for acts of ESAs in individual cases, with qualified majority voting used for horizontal matters such as the proposal of binding technical standards, recommendations and guidelines, and financial and budgetary decisions.

- *Involvement and role of relevant stakeholders*. The lack of any stakeholder consultation other than ad hoc public consultations would lead to poor quality interventions. Holding open public consultations on every act of the ESAs would also be inefficient. A single stakeholder consultative group would be incoherent given the varying nature of the work of the three ESAs. Therefore, separate consultative groups for each ESA are considered optimal.

For the ESRB, the areas considered under this heading were:

- *Size of board and scope of expertise*. For the effectiveness of the ESRB, the board must ensure adequate representation of expertise and views. The Commission proposal endorsed by the European Council suggests a board comprising:

    * The President and Vice President of the European Central Bank;

    * Governors of each of the EU's National Central Banks;

    * One representative of the European Commission;

    * Representatives of each of the European Supervisory Authorities;

    * One non-voting supervisory representative from each Member State;

    * One non-voting representative from the Economic and Financial Committee.

- *Addressees of warnings*. It seems that the most effective option to meet the objectives of the ESRB would be a range of addressees (Member States, national supervisors, European Supervisory Authorities and the Commission). It would be ineffective and inefficient to limit the scope of potential addressees. For a macro-prudential body, it seems unnecessary to include individual financial institutions as possible addressees.

- *Stakeholder involvement and consultation*. A Technical Advisory Group, putting together experts from the different institutions participating to the ESRB was considered useful to refine the analysis of the Secretariat when appropriate. Ad hoc wider consultations should also not be ruled out.

c. Financing

For the ESFS, the options considered ranged from 100% financing from the Member States to 100% financing from the Community budget. 60% financing by Member States and 40% Community subsidy has been selected. This balance will ensure independence of ESAs both from Member States and the Community, give stability of funding, and reflect the important Community dimension of the ESAs' objectives.

Regarding the ESRB, the options evaluated regarded the provision and location of the secretariat: whether this should be done by the Commission, a virtual network of Central Banks or the European Central Bank. It was considered that the most appropriate option for the ESRB secretariat was that it should be provided by the European Central Bank.

6. IMPACT OF THE SELECTED OPTIONS

The specific impacts on various entities directly concerned by the establishment of the ESRB and ESFS can be analysed as follows:

- ***National supervisors.*** The ESAs will contribute to harmonisation of financial supervision in the EU, by proposing binding technical rules and monitoring application of EU rules by national supervisors. They will also facilitate functioning of colleges of supervisors, and run information databases of benefit to supervisors participating in colleges. National supervisors will be able to bring appeals against decisions taken by the European Supervisory Authorities. The ESRB should help national supervisors to better understand the impact of their actions on the wider economic and financial system. National Supervisors may however have a greater burden in terms of information provision and a requirement to "comply or explain" following the receipt of an ESRB recommendation.

- ***National Finance Ministries.*** These will benefit from enhanced financial stability across the EU, and reduced risk of expensive bail-outs of financial institutions. They will have access to the analyses of systemic risks carried out by the ESRB, and will receive warnings and recommendations if necessary. The fiscal responsibility of Member States will be protected by the safeguard clause in the ESA Regulations. On the other hand, Member States may have to contribute to finance the European Supervisory Authorities, according to the funding arrangements to be determined.

- ***Level 2 and 3 Committees.*** With the establishment of the ESFS, the Level 3 committees will cease to exist and their functions will be fully taken over by the

ESAs. However, the new Authorities will as far as possible ensure continuity with the Level 3 committees. Maintenance of current staff, and growth in staff numbers, is foreseen. The Level 2 committees will continue as at present.

- ***European Central Bank.*** The European Central Bank will be involved both through participation in the ESRB and through the provision of the Secretariat to the ESRB.

- ***National Central Banks.*** **P**articipation in the ESRB and the input to the work of the Secretariat should not involve any significant additional costs for national central banks.

- ***Financial institutions.*** For large financial groups, the improved cross-border and cross-sector supervision will reduce compliance costs thanks to harmonised standards and supervisory practices. The ESRB will contribute to an improved business environment through effective crisis prevention in the EU. Credit Rating Agencies registered in the EU will be able undergo direct supervision by the European Securities Markets Authority, ensuring greater coherence and cost reduction. The establishment of the Joint Steering Committee for three ESAs will be a basis for further strengthening of oversight of financial conglomerates.

- Other stakeholders. To ensure appropriate input of stakeholders into the decision making process of the ESAs, a dedicated stakeholder group will be created for each authority, with thirty members representing in a balanced way consumers, industry and employees. The ESRB will have the ability to consult widely as appropriate, and have access to a technical advisory group.

The costs of the ESFS have been estimated according to three cost categories: staff costs, infrastructure costs and operations costs. The total costs of creating the European Supervisory Authorities has been estimated at about 36 million Euro in the first year of operations (2010), reaching over 67 million Euro after three years (2013). The staff cost estimates are based on the assumption that each ESA will aim to double its staff as compared to the staff numbers in the existing Level 3 Committees in the first year of its operation, an average increase from 20 to 40 in each of the three Authorities.

Regarding the ESRB, as its secretariat will be provided by the European Central Bank and the European System of Central Banks, no direct cost will accrue to the Community budget nor to the budgets or Member States, except as regards seconded staff.

7. MONITORING AND EVALUATION

The Regulations establishing the ESFS and the ESRB provide for evaluation of the new system for European financial supervision three years from the effective start of its operation. The Commission will prepare two reports on the experience with functioning of the ESFS and ESRB respectively. The final set of indicators will be decided by the Commission at the time of conducting the required evaluations.