

The Banking Supervision Committee of the ESCB and its contribution to financial stability in the EU

The Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB) was established in 1998 to assist in the fulfilment of the ESCB's statutory tasks in the fields of prudential supervision of credit institutions and the stability of the financial system.¹⁾ The BSC is composed of high-level representatives from the EU banking supervisory authorities, national central banks and the ECB, the latter providing also the Secretariat to the Committee. The European Commission and the Committee of European Banking Supervisors (CEBS) have observer status in the BSC. Since its establishment as an ESCB Committee, the BSC has been chaired by Edgar Meister who has greatly contributed to its work and has steered the Committee's deliberations in a very effective, smooth and congenial manner.

This contribution provides an overview of the activities of the BSC since its inception. It starts by recalling the historical background that led to the establishment of the BSC and influenced its further evolution. The article then reviews the accomplishments of the BSC in the fulfilment of its mandate and concludes with some reflections on the Committee's future activities.

Enhancing interaction

The BSC can look back on a long tradition as a forum for the multilateral information-sharing and cooperation between EU central banks and banking supervisors. Its roots can be found in the Banking Supervisory Sub-Committee of the Committee of Governors of the Central Banks of the European Community, which was set up in 1989. At that time, the committee was an informal group of banking supervisors from the central banks of the Community (and, in cases where the central bank did not have legal responsibility for banking super-

vision, of senior representatives of the respective supervisory authorities) under the chairmanship of Brian Quinn, taking the first steps towards defining its own role in enhancing the interaction between central banking and banking supervision functions, particularly in the context of Stage One of Economic and Monetary Union (EMU), which began on 1 July 1990 with the lifting of all restrictions on the movement of capital between Member States.

Stage Two of EMU started on 1 January 1994 with the establishment of the European Monetary Institute (EMI) and the EMI Council then assumed the tasks and activities of the Committee of Governors. The

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Sowohl die Einführung der Einheitswährung Euro und die wachsende Anzahl an international operierenden Instituten, so der Autor in seiner Bestandsaufnahme, wie auch die Ausweitung des Lamfalussy-Verfahrens auf alle Finanzsektoren haben die Überwachung der Stabilität des EU-Finanzsystems und die Erarbeitung entsprechender regulatorischer und aufsichtsrechtlicher Werkzeuge in den Mittelpunkt des Banking Supervision Committees gerückt – so etwa im Rahmen der IFRS oder von Solvency II. Gegenwärtig sei das Komitee mit der Analyse der pro-zyklischen Auswirkungen der neuen Capital Requirements Directive auf die Finanzstabilität in der EU beschäftigt. Auch wenn er die Wahrscheinlichkeit für Finanzkrisen in Europa als gering einschätzt, müsse die künftige Rolle des BSC aufgrund der höheren Durchschlagskraft von etwaigen Schieflagen bei der Ausarbeitung angemessener europäischer „Mindeststandards“ sowie der Schaffung von geeigneten Vorkehrungen für das Krisenmanagement liegen. (Red.)

Banking Supervisory Sub-Committee was duly incorporated into the structure of the EMI, so that it could play its role in the pursuit of the EMI's objectives, namely to strengthen central bank cooperation and monetary policy coordination, and to make the preparations required for the establishment of the ESCB, for the conduct of the single monetary policy and for the creation of a single currency.

Under the stewardship of Tom de Swaan, the EMI Banking Supervisory Sub-Committee devoted itself to three main preparatory tasks for Stage Three. First, it provided advice on the policy content of the ESCB tasks relating to the prudential supervision of credit institutions and the stability of the financial system. Second, it contributed – from a banking supervision perspective – to the regulatory and organisational framework necessary for the performance of some of the Eurosystem's central banking tasks in Stage Three. Third, it also provided a forum for the multilateral exchange of views on banking supervisory issues in the European Union that were not directly related to the future activities of the ESCB.

Cooperation between the Eurosystem and national authorities

The BSC was formally set up after the establishment of the ECB on 1 June 1998. In addition to its role of assisting in the fulfilment of the ESCB tasks, the creation of the BSC was instrumental in fostering the smooth cooperation between the Eurosystem and the national banking supervisory authorities. This was particularly important given that the introduction of the euro on 1 January 1999 led to an unprecedented situation where the jurisdiction for the single monetary policy, encompassing eleven Member States at the time, and the jurisdiction for banking supervision, which



remained national, did not coincide any longer. The BSC thus provided a platform to bridge this institutional asymmetry between the performance of central banking functions at the euro area level and the conduct of the national supervisory tasks.²⁾

In responding to this institutional challenge, an understanding emerged among the authorities represented in the BSC that it was essential to establish a framework of cooperation between central banks and banking supervisors which would ensure that this asymmetry would not play a significant role in practice. This did not imply a move in the direction of establishing a single supervisory authority, but rather it aimed at establishing the conditions that would allow the national supervisors to operate as effectively as a single authority, when needed.

Evolving role of the Banking Supervision Committee

In recent years, the role and contribution of the BSC has further evolved in line with two main developments. First, the deepening in EU financial integration after the introduction of the euro led, inter alia, to a growing number of credit institutions with extensive/substantial cross-border activities. This requires enhanced monitoring on the part of central banks and banking supervisors for the purpose of safeguarding financial stability. Second, the extension of the Lamfalussy framework³⁾ for financial regulation and supervision to all financial sectors at the end of 2003 led to a new architecture of financial services committees aimed at strengthening the cooperation between supervisors and at fostering the convergence of supervisory practices.

In the field of banking, the relevant newly established body was the CEBS. As a result, the mandate of the BSC was revised by the Governing Council of the ECB in 2004 to reflect these developments. The new mandate provided for an enhanced focus on financial stability analysis and on the macro-prudential perspective in its work of contributing to the design of financial regulation and supervisory tools.

Over the past few years, the work and output of the BSC – notably its published reports – have gained a higher public profile, also thanks to the efforts and activities of Edgar Meister, and have helped to demon-

strate to the markets and the public at large that the ESCB is at the “cutting edge” with regard to financial stability analysis, tools and methodology, and keeps abreast of developments in a rapidly changing and increasingly complex financial system.

Financial stability as the primary objective

The BSC consists of representatives from both central banks and banking supervisory authorities. The Committee's composition helps to link the macro-prudential and the micro-prudential perspectives in its work. The BSC membership extends to the entire European Union and is not restricted to euro area countries only, since financial institutions' activities are not necessarily confined to the euro area but may encompass the EU's single financial market as a whole. The BSC can, however, meet and deal with specific issues also in a euro area composition. While this is not the prevalent modus operandi of the Committee, BSC members representing the national financial stability and supervisory authorities in the euro area could be required to support the Eurosystem on specific issues of relevance to the area.

According to its mandate, the first and primary task of the BSC is the contribution to monitoring and assessing developments in the euro area and EU banking and financial sectors from a financial stability perspective. This includes the analysis of both conjunctural and structural developments mainly in the banking sector but also in other segments of the financial system, for instance in the insurance and hedge fund industries. Therefore, the macro-prudential perspective and the financial stability mission of the BSC are very clearly highlighted in its mandate. In this context, the BSC also contributes to the preparation of the ECB's Financial Stability Review, the ECB's flagship publication in the field of financial stability.

A second task of the BSC is the contribution to the design of financial regulation and supervisory tools from a macro-prudential perspective. Financial regulation is understood in a broad sense that includes all relevant areas relating to financial services (for instance accounting, corporate governance, safety net). This task entails analysing the possible effects of regulatory or supervisory requirements on the func-

tioning of the financial institutions and markets, on banking and financial structures and on financial stability. In this context, the BSC assists in the preparation of the ECB's advice on draft Community and national legislation.⁴⁾

The third task of the BSC is the promotion of cooperation between central banks and banking supervisors on issues of common interest. This mainly relates to the development of cooperation arrangements between central bank and supervisory functions, namely in the fields of central bank operations, payment systems and crisis management. The work of the BSC on these three fundamental tasks has been substantive and extensive as I will outline in the sections below.

New developments in the EU financial sector

The BSC contributes to the production of several publications on financial stability issues relevant to the euro area and the EU. These include the regular annual BSC reports on banking stability and structural developments in the EU banking sector, as well as the ECB's Financial Stability Review referred to earlier. In addition to these regular reports, the BSC also analyses specific topics on an ad hoc basis, whenever they are relevant from a financial stability perspective.

With regard to the monitoring of conjunctural developments, the Committee identifies each year two or three main topics and examines pertinent market developments which may affect the risk profile of the banking sector. Recent examples include the analysis of exposures of EU banks to the hedge fund industry and to the private equity sector. The monitoring of structural developments involves the selection of topics of longer-term relevance. For example, the Committee recently analysed the impact of population ageing on the banking sector and the changing structure of the funding of EU banks.

Beilagenhinweis

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The development and refinement of methodologies for macro-prudential analysis also form part of the BSC's contribution to financial stability monitoring. In this field, the BSC has undertaken, inter alia, work on the development of techniques for macro stress testing and contributed to the definition of the Financial Soundness Indicators developed by the International Monetary Fund.

Finally, the Committee has analysed structural developments of a cross-sectoral nature, such as the implications of EU banks' credit risk transfer activities and the cross-sector risks in the context of financial conglomerates.

The activities of the BSC in this area have contributed to enhancing the general understanding of the possible effects of market developments on financial stability for the euro area as a whole. Then has also helped national central banks in their domestic financial stability assessments and national supervisory authorities in their monitoring of individual financial institutions. Moreover, the BSC has effectively contributed to the development of tools and methodologies for financial stability assessment which are important for the performance of financial stability function of central banks.

Design of financial regulation and supervisory tools

In the eight years since its establishment, the Banking Supervision Committee has devoted substantial efforts to the analysis of the impact of regulatory and supervisory requirements on the structure and stability of the financial system. First, the Committee has assessed several regulatory and supervisory issues relating to the development of cross-border banking activity in the European Union, including liquidity-risk regulation and supervision.

Second, it has provided an important contribution to the finalisation of the International Financial Reporting Standards in the specific domain of the possible impact of full fair value accounting on financial stability. Third, on the explicit request from the European Commission, the BSC has analysed the possible financial stability implications of the new regulatory regime for insurance undertakings (Solvency II). Finally, it has made specific contributions on the

supervisory framework for payment system institutions.

At present, the BSC is engaged in preparing an assessment of the development of an analytical framework to monitor the possible pro-cyclical effects of the EU Capital Requirements Directive. Overall, the BSC's contributions to this field have emphasised and enhanced the significance of the financial stability perspective in the design of financial regulation at both the EU and national levels.

Prevention and effective handling of financial crises

The BSC also contributes to the design of arrangements for cooperation and exchange of information between banking supervisors and central banks for the prevention and the effective handling of financial crises. In this area, the BSC prepared the first Memorandum of Understanding (MOU) between EU supervisors and central banks which was signed in 2003 and could be considered as a building block of further cooperation arrangements. The BSC also supported the preparation and adoption of a second MOU on cooperation between EU banking supervisors, central banks and finance ministries which was adopted in 2005 under the aegis of the Economic and Financial Committee (EFC).⁵⁾

As part of the follow-up work to ensure the effective implementation of these MOU, the BSC and the CEBS recently developed recommendations to assist EU banking supervisors and central banks in enhancing their arrangements for responding to a cross-border financial crisis. Furthermore, the members of the BSC also contributed to the preparation and conduct of the recent EU-wide crisis simulation exercise organised to test the existing arrangements for cross-border cooperation in a crisis situation with a view to improving the degree of preparedness in addressing a real stress situation.

Overall, the activity of the BSC in this area has helped to establish a climate of mutual trust between central banks and bank supervisors which has led to an increase in cooperation and information exchange between the two sets of authorities.

In addition, the BSC contributes to the activities of EU and international fora and

institutions in various ways. Its Chairman participates in the deliberations of the EFC Financial Stability Table,⁶⁾ which take place twice a year, and presents a summary of the Committee's regular analyses of banking system stability and structural developments, as well as input to the enhancement of the EU institutional framework for regulation, supervision and crisis management.

The BSC also maintains close working arrangements with the CEBS in order to strengthen cooperation on matters of common concern, and to contribute to each other's work in a complementary manner. Moreover, it cooperates with the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), with a view to expanding the analyses relevant for financial sector stability and developing common projects.

Finally, the BSC is instrumental in preparing the contributions of the European Central Bank and the entire Eurosystem to the regulatory activities of the European Commission, inter alia, on deposit insurance schemes and winding-up procedures, as well as to other international fora, including the Basel Committee on Banking Supervision and the Financial Stability Forum.

An increasingly complex and rapidly changing financial system

After the recent rounds of enlargement of the EU, the BSC comprises representatives from the central banks and supervisory authorities of 27 countries. It has developed its role over time and gained a reputation as a forum that contributes to the assessment of financial stability in the euro area and the EU and to the analysis of regulatory and supervisory issues from a macro-prudential perspective and that promotes the cooperation between EU central banks and banking supervisors. The Committee's high quality work, which is reflected in regular publications ad hoc reports, is recognised and appreciated within the European institutional framework.

Looking forward, the Committee will continue to play a major role in identifying and analysing threats to the stability of the EU banking and financial sector in the context of an increasingly complex and

rapidly changing financial system. The BSC will intensify its contribution to the design of sound regulatory requirements as part of the current efforts towards better regulation at both the EU and global levels.

Finally, the Committee will seek to enrich its contribution to the enhancement of arrangements for effective financial crisis management in the EU against a background where financial crises might have become less probable, but their impact – if they occur – could be potentially substantial. All these objectives will be pursued by continuing to exploit the potential of the unique synergies obtained by the combination of the macro- and micro-prudential perspectives of central banks and supervisory authorities, respectively, as Edgar Meister has correctly observed.⁷⁾

Footnotes

¹⁾ These statutory tasks are laid down in the Treaty establishing the European Community and the Sta-

tute of the European System of Central Banks (ESCB) and of the European Central Bank (ECB). In accordance with Article 105 (5) of the Treaty, and Article 3.3 of the Statute, "The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system."

²⁾ For an overview of the range of issues concerning the interaction between central banking functions and banking supervision, see Tommaso Padoa-Schioppa, "EMU and Banking Supervision", lecture at the London School of Economics on 24 February 1999, available on the ECB's website (<http://www.ecb.int>).

³⁾ The Lamfalussy framework is a four-level process for legislating at the EU level in the fields of securities, banking and insurance regulation. Level 1 consists of framework principles, namely in the form of Directives or Regulations, to be decided by normal EU legislative procedures. Level 2 arranges for the implementation of detailed measures following the Level 1 framework principles. Level 3 involves enhanced cooperation and networking among EU supervisors to ensure consistent and equivalent transposition of Level 1 and Level 2 legislation. Level 4 consists of strengthened enforcement, notably with action by the Commission to enforce Community law, underpinned by enhanced cooperation between

Member States, their regulatory bodies and the private sector.

⁴⁾ In accordance with Article 105 (4) of the Treaty and Article 4 of the ESCB and ECB Statute, the ECB is consulted, or may submit opinions on its own initiative, on Community acts and also by national authorities regarding draft legislative proposals in its fields of competence. In accordance with Article 25 (1) of the ESCB and ECB Statute, the ECB may also offer advice and be consulted by the Council, the Commission and the competent authorities of the Member States on the scope and implementation of Community legislation relating to the prudential supervision of credit institutions and to the stability of the financial system.

⁵⁾ The Economic and Financial Committee (EFC) was established by the Treaty to provide advice to the ECOFIN Council and to the Commission and comprises high-level representatives from finance ministries and central banks.

⁶⁾ In this special format, the EFC addresses specifically financial stability-related issues and comprises also the Chairs of the BSC and the Level 3 Committees.

⁷⁾ See also Edgar Meister, "Risiken in Finanzsystem: Herausforderungen für Bankenaufsicht und Notenbank", contribution to the Centre for Financial Studies (University of Frankfurt), Frankfurt am Main, 11 May 2005.