

Insideview

Financial Supervision in the EU

INTERVIEW WITH DR. BERNHARD SPEYER, DEUTSCHE BANK RESEARCH

As a response to the financial crisis, the European Commission proposed a reform of the structure of financial supervision in the European Union (EU). Since January 2011, the newly formed European System of Financial Supervision (ESFS) monitors financial stability within the EU. Until last, Germany and the United Kingdom favored national supervisory authorities over the pan-European solution. What are the benefits of a holistic European system from your perspective?

There are two aspects to this: First, the intertwining of macro- and micro-prudential supervision under a common roof, the ESFS. This is sensible, because only the combination of the two can ensure financial stability. Having said this, while this is conceptually evident, putting into place an effective intertwining of both types of supervision in day-to-day practice is difficult. But the framework established is sound and will, for sure, grow into a holistic approach over time. The second aspect is the desirability of pan-European supervision: In a

single EU financial market with large cross-border institutions, only an EU-level structure can ensure effective supervision and financial stability and will avoid competitive distortions.

How far is the current set-up away from a truly holistic independent system? Where do you see critical points limiting the success of the current consent?

In the area of micro-prudential supervision, the main weakness of the new set-up is that the European Supervisory Agencies (ESAs) have only very limited direct supervisory powers. To what extent they will be able to gain weight vis-à-vis national supervisors through setting rule-books, peer review, arbitration and emergency powers is an open question. As to macro-prudential supervision, the European Systemic Risk Board (ESRB), too, has only limited hard power, but will have to exert influence by projecting "soft power", i.e., through the quality of its analysis and recommendations and by means of communicating with the markets.



Dr. Bernhard Speyer
Deputy Head
Deutsche Bank Research

Does the ESFS, as it is designed and in operation, now reflect the right conclusions drawn from the financial crisis?

Only partly. The ESRB clearly closes an identified gap in the supervisory structure. While its structure appears a bit unwieldy, it will nonetheless be a crucial element in preventing financial imbalances, which may threaten financial stability, from arising in the first place. In contrast, the ESAs are clearly too weak to really put the stability of Europe's financial markets on a firmer footing and to deal more effectively with cross-border crises compared to what we saw in the past couple of years. I fear that too many policy-makers still have not grasped that nation-based financial supervision is ultimately not compatible with a fully integrated financial market. Either we move towards EU-level supervision or there will be market re-fragmentation.

Does Deutsche Bank Research expect significant changes to the banks' business

model due to the implementation of the ESFS?

No, it is not necessary to change entire business models in reaction to the establishment of the ESFS. But banks will need to monitor closely, in particular, the actions of the ESRB. Macro-prudential supervision, by definition, affects banks irrespective of their own risk situation and may limit the growth of business even if the bank itself had ample capital at its disposal and a healthy asset base.

How vocal and forceful do you expect the ESRB to be?

Initially, the ESRB will probably move cautiously. Tools for macro-prudential supervision are largely untested and in the current market environment, the ESRB will want to avoid creating further uncertainty. Also, experience must be gained on how markets and authorities react to ESRB warnings and recommendations.

Thank you for this interesting conversation.