Regulation and Supervision of Financial Markets and Institutions

A European Perspective

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This presentation reflects the personal views of the speaker. They are not necessarily identical with the opinion of the FMA.
Policy Aspects in Financial Markets

COMPETITION
- ABUSE OF MARKET POWER
- INFORMATION ASYMMETRIES
- UNFAIR COMPETITION

SECTORAL REGULATION AND SUPERVISION OF NATURAL MONOPOLIES

CONSUMER PROTECTION
- MARKET CONDUCT SUPERVISION
- INDIVIDUAL CONSUMER PROTECTION

FINANCIAL STABILITY
- Payment System
- SYSTEMIC STABILITY
- Individual Institutions
- MACRO PRUDENTIAL SUPERVISION
- MICRO PRUDENTIAL SUPERVISION

MONETARY STABILITY
- PRICE STABILITY

CENTRAL BANK FOCUS

PRUDENTIAL SUPERVISOR FOCUS

PUBLIC LAW
SYSTEMATIC REVIEW
CIVIL LAW
CASE-BY-CASE REVIEW

LEGAL BASIS AND PROCEDURE

‘TWIN PEAKS’
Definition of Financial Stability

• Monetary Stability vs. Financial Stability

• Issing (2003):
  - ‘systems approach’ definitions: unimpaired capacity of financial institutions and markets to efficiently mobilise savings, provide liquidity and allocate investment (Mishkin 1991)
  - related to volatility of directly observable financial variables: absence of banking crises, price stability, interest rate smoothness,…

• Tolerance for financial institutions’ failure
Regulation and Supervision

- Academic perspective vs. real world
- Supervisors with rule-making powers for refining legislation
Behavioural Views on Market Intervention

• Stigler (1971) and Posner (1974):
  ➢ self-interest of bureaucratic agents
  ➢ idea of a political economy where those interest groups best organised make themselves heard (public choice)

• Results:
  ➢ vague regulatory targets
  ➢ entry barriers
  ➢ undermined competition
National Perspective

• Central Bank to integrate macro- and micro-financial stability supervision, i.e. payment system and banking supervision
  ➢ consolidation of macro and micro aspects of monetary and financial stability supervision

• Integrated Supervisory Body to integrate the supervision of all financial market intermediaries
  ➢ consolidation of the supervision of all sectors of financial intermediaries whether systemically relevant or not

• Integration of all tasks
Dimensions of Independence

- Budgetary Independence
- Institutional Independence
- Regulatory Independence
- Supervisory Independence

MARKET DISTANCE

DEGREE OF FORMALITY OF POTENTIAL CAPTURE
‘Vertical’ distance of control operations from the market

- Regulatory independence: ability to have an appropriate degree of autonomy in setting (technical) rules and regulations
  - may be restrained by political interference
- Supervisory independence:
  - maintenance of a certain degree of discretion
  - system not rendering the right of appeal a means of cheap escape.
  - appropriate salary and legal protection for the individual supervisor
Dimensions of Independence 2

‘Horizontal’ aspect: formality of potential interference

- Budgetary independence
- Institutional independence
  - terms of employment (appointment and dismissal) of senior personnel
  - governance structure
  - openness and transparency of decision making.
Dimensions of Independence 3

Discretion and individual protection in individual cases

• Statutory vs. Case law

• Law-based system of sanctions and interventions more transparent and more amenable to judicial review

• Protection of supervisor
Horizontal Cooperation in Supervision

- **COMPETITION**
  - Sectoral Regulation and Supervision of Natural Monopolies
    - Abuse of Market Power
    - Information Asymmetries
    - Unfair Competition

- **CONSUMER PROTECTION**
  - Individual Consumer Protection

- **FINANCIAL STABILITY**
  - Payment System
    - Systemic Stability Individual Institutions
  - Macro Prudential Supervision

- **MONETARY STABILITY**
  - Price Stability

- **CENTRAL BANK FOCUS**
- **PRUDENTIAL SUPERVISOR FOCUS**

**Legal Basis and Procedure**

- **PUBLIC LAW**
- **SYSTEMATIC REVIEW**
- **CIVIL LAW**
- **CASE-BY-CASE REVIEW**
Horizontal Cooperation 2

• Conduct of business

➢ Different legal objectives across sectors
  ▪ Different focus in banking and insurance
  ▪ Prudential view strengthened in insurance regulation (Solvency II)
Vertical Cooperation in Supervision

- **COMPETITION**
  - Abuse of Market Power
  - Information Asymmetries
  - Unfair Competition

- **CONSUMER PROTECTION**
  - Market Conduct Supervision
  - Individual Consumer Protection

- **FINANCIAL STABILITY**
  - Payment System
    - Systemic Stability
    - Individual Institutions
  - Macro Prudential Supervision
  - Micro Prudential Supervision

- **MONETARY STABILITY**
  - Price Stability

- **LEGAL BASIS AND PROCEDURE**
  - Public Law
  - Systematic Review
  - Civil Law
  - Case-by-Case Review

- **CENTRAL BANK FOCUS**
- **PRUDENTIAL SUPERVISOR FOCUS**

'TWIN PEAKS'
Central Banks

• Monetary Stability
  ➢ Price stability
    ▪ Tools
      – Interest Rate Policy
      – Open Market Policy

• Transmission mechanism

• Financial Stability
  ➢ Payment system stability
Organising Europe

- Trend towards integrated regulators and supervisors
- Cooperation: Home country control (mutual recognition)
- Coordination: Secretariats
- Comitology:
The Comitology Architecture

Lamfalussy
Level I
'LEGISLATIVE BROAD FRAMEWORK PRINCIPLES'

ECOFIN COUNCIL

EUROPEAN COMMISSION (EC)

EUROPEAN PARLIAMENT

FSC
FINANCIAL SERVICES COMMITTEE
COOPERATION OF SUPERVISORS AND CRISIS MANAGEMENT

EFC
ECONOMIC AND FINANCIAL COMMITTEE
EXAMINES ECONOMIC AND FINANCIAL SITUATION, REPORTS ON FINANCIAL MARKET INTEGRATION

EUROPEAN BANKING COMMITTEE (EBC)

EUROPEAN INSURANCE COMMITTEE (EIC)

EUROPEAN SECURITIES COMMITTEE (ESC)

EUROPEAN FINANCIAL CONGLOMERATES COMMITTEE (EFCC)

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Level II
'RULE-MAKING'
EC (Chair), Regulators (vote), Technical Experts

Lamfalussy
Level III
'CONVERGENCE OF PRACTICES, CONSISTENT IMPLEMENTATION OF DIRECTIVES'

COMMITTEE OF EUROPEAN BANKING SUPERVISORS (CEBS)
Competent Supervisors (chair + vote), Central Banks, ECB
Observer: EC, GdC, BSC, Supervisors EEA

COMMITTEE OF EUROPEAN INSURANCE AND OCCUPATIONAL PENSION SUPERVISORS (CEIOPS)
Competent Supervisors (chair + vote) + EC

COMMITTEE OF EUROPEAN SECURITIES REGULATORS (CESR)
Competent Supervisors (chair + vote) + EC

CONSULTATION
CONSULTATIVE PANEL OF MARKET PARTICIPANTS

TECHNICAL ADVICE TO COMMISSION ON REGULATION

INFORMATION

ADVICE

FRAMEWORK DIRECTIVES

CO-DECISION
Pan-European Perspective

• Conglomerates
• One-Stop-Shopping
• Regulatory Arbitrage
• Transaction costs
Pan-European Supervisor?

- Virtues of decentralisation/ need of concentration
- Transaction costs at another level
- Regulatory competition
Summing up

- Potential conflicts of interest
- Behavioural aspects
- Separation of tasks / clear target functions

- European view:
  - Necessity for harmonisation and coordination
  - Pan-European supervisor vs home country control with cooperation and convergence