De Larosière: fine recommendations fail to tackle main issues[1]

In its report, the High-Level Group that was to rethink the EU supervisory landscape comes up with a fine analysis of the manifold causes of the financial crisis. The Group headed by Jacques de Larosière rightly proposes some far-reaching solutions. They include revising Basle II, broadening supervision to include credit rating agencies and introducing dynamic provisioning for banks, already required by the *Banco de España*. The Group's insistence that financial sector rules should be adopted in EU-wide regulations rather than in directives that are translated into 27 national laws and its suggestion to drop most national exemptions to EU financial standards by 2011 are welcome. A truly European rulebook would emerge, something for which the ECB has pleaded for a long time. The Group's suggestions to enhance the effectiveness of national supervisors, by subjecting them to directions from EU coordinating bodies, are far-reaching. These national authorities would have to abide by decisions on supervisory practice taken at EU level. They would be subject to scrutiny of their effectiveness and independence by their peers. When considering the disciplining powers of financial supervisors, the Group finds inspiration in the level of fines imposed for competition law infringements. If its recommendations are followed, competition authorities may, in turn, find inspiration in the financial sector for aligning their practices in the way proposed by *de Larosière*.

In spite of all these welcome recommendations, the de Larosière Report fails to tackle the main fault lines that the credit crisis has shown to exist in the EU supervisory landscape. Let us mention three.

'Beefed-up' so-called Lamfalussy committees, the present groups of supervisors coordinating oversight, may be called "European Authorities" but would still lack decision-making power. We understand the Group's reliance on national authorities close to the firms and markets to execute day-to-day supervision. Yet, its proposals fail to acknowledge that these national agencies need to be subject to single EU-wide decision-making, at least in respect of the larger financial institutions. The Report does nothing to repair the absence of clear EU-wide authority to take decisions, also in respect of the supervision, bail-out or liquidation of individual firms, or the clear lack of effectiveness of colleges of supervisors (see Fortis) which already operated without transparent decision-making. Also, it does not redress the current situation in which responsibility for the operation of independent supervision remains with national political authorities and, thus, dispersed across the internal market, and heavily tilted towards national bias, as the current crisis has shown.

Concerning colleges of supervisors, the Report introduces innovative elements to ensure a level playing field between larger institutions supervised by such colleges and other players on the market. But the Report does not address the danger that each such college will develop differently from its peers overseeing other cross-border firms, which would undermine effective supervision and a level playing field among the larger institutions themselves. Colleges of supervisors for each of the

[1] Also available at: http://www.euractiv.com/29/images/De%20Larosi%C3%83%C2%A8re%20-%20fine%20recommendations%20fail%20to%20tackle%20main%20issues%20(2)_tcm29-181013.doc

major cross-border financial institutions risk the continuation of a patchwork of supervisory standards, as these colleges consist of different authorities, reflecting the national markets in which the institutions supervised are active. They will have different ideas on how to act in the face of prudential concerns or when the bank is in distress. This does nothing to enhance the unity of the market or of its overseers.

A third flaw is the timidity of the Group's proposals in respect of deposit guarantee schemes. An EU-wide fund to finance pay-outs is exactly what should be considered to prevent 'passing the buck' problems, whereas the Group's idea that host States may restrict deposit taking to avoid 'Icelandic problems' is at variance with the core principle of the single market.

In all these respects, the Group has invoked the lack of political will to go beyond its proposals. If even a group of experts cannot muster the courage to lay out imaginative blueprints, one can hardly expect politicians who have failed thus far to rise to the occasion and face head-on Europe's current challenges, to go beyond the timidity of the Report they commissioned. It is especially disappointing to see that the Group argues against giving the ECB powers in the area of prudential supervision. Its arguments are flawed: they cite an alleged lack of expertise with the ECB and the need to preserve its independence. Lack of expertise can be remedied. Many central banks across the globe perform their monetary policy functions in full independence and act as prudential supervisor, also independently but responsible vis-à-vis national government or parliament. The Report itself emphasises the need for independence of prudential supervisors, even though acknowledging that this measure of independence does not go as far as central bank independence. Coordination between central banks and prudential supervisors is necessary in any case: it can either be organised inter-agency (when monetary policy and prudential supervision are performed separately) or intra-agency (when a single authority performs both functions). Not making the ECB competent or, at least, closely involving it in prudential supervision is a mistake which the Report should not have made.

There is also a need for further alignment of national competences in respect of bank bailouts, including *ex ante* agreement on burden sharing in case of failure of a major cross-border firm and, perhaps, even EU-wide fiscal authority to step in to avoid financial disasters in the future. In any case, without a clear focus of authority for steering supervision in its overall approach and in individual decisions, and without the accompanying accountability before EU-wide bodies (Commission, European Parliament), the internal market in financial services will remain carved up. Perhaps, some of our more far-reaching ideas require technical amendments of the Treaty. But so may some of *de Larosière*'s proposals. For all its wisdom and sometimes far-reaching suggestions, the de Larosière Report fails us. Europe deserves better solutions.

26 March 2009 – Laurens Jan Brinkhorst, Professor, University of Leiden / Jean-Victor Louis, Professor emeritus, Université Libre, Brussels / René Smits, Professor, University of Amsterdam