Supervisory Colleges: Way Forward or Red Herring?

Nicolas Véron

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On 15 November the G20 countries stated in their Washington declaration that: 'The supervisors are to work together to create supervisory colleges for all large cross-border financial organisations in order to reinforce the supervision of cross-border companies.' What is this all about?

Until the start of the 1990s most large financial companies were almost exclusively national in their activity. Then the financial world globalised at breakneck speed.

International coordination problems surfaced, notably with the collapse of BCCI in 1991 and Barings in 1995. However, this was not enough to justify major reform of the system.

In 2004 the European Union created a committee of national banking supervisors but it operates on a consensus basis and has no formal power beyond that of issuing opinions for the attention of the EU institutions.

As long as the sun was shining on the financial system, the shortcomings in these arrangements troubled only a handful of experts.

But since the crisis has hit, the absence of a credible framework for the supervision of cross-border groups has becoming a gaping hole in Europe's regulatory system.

The fragmentation between several national authorities, such as the Financial Services Authority in the UK or the *Commission bancaire* in France, result in neither of them being able to form a full picture of the overall financial commitments of a given group.

It causes additional costs and above all reflects less and less the way cross-border groups increasingly aggregate functions at a regional or global level. Such groups can no longer be boiled down to a cocktail of national entities susceptible to separate financial health and risk assessment.

'Supervisory colleges' are intended as a response to these shortcomings. They would offer a formal structure bringing together the relevant national authorities under a 'lead supervisor', which would generally be the home country authority.

This proposal is being promoted by both the UK and France, who have spotted a means of reforming the current framework without having to create an EU-level authority.

But supervisory colleges, attractive as they may be on paper, are not working in practice.

The reason is that countries where subsidiaries of foreign financial groups have major systemic importance cannot accept key regulatory decisions being taken in a foreign capital.

France and the UK, where the vast majority of retail financial services firms are domestically headquartered, sometimes sound as though they were not fully aware of this obstacle.

By contrast, in Central and Eastern Europe, but also in Belgium and Finland, most large financial companies are now local branches of foreign groups.

In such countries, either the mechanism would provide for no substantive delegation of power to the lead supervisor, in which case the situation would be akin to the status quo. Or else there is substantive delegation, and that would be politically unfeasible.

Moreover colleges may spur regulatory competition with potentially harmful consequences. In Finland, for example, the three main banks would each have a different lead supervisor, one based in Stockholm, one in Helsinki and one in Copenhagen.

Each one of these public authorities would naturally tend to defend the interests of 'its' champion against those of its counterparts, which would hardly contribute to consistent public policy.

In insurance, these contradictions have already come to the fore. The 'Solvency II' directive was meant to establish supervisory colleges for cross-border insurance firms. But owing to a failure to find consensus, the compromise of the French presidency will not deal at all with the issue of supervisory organisation.

In the case of banks, colleges were planned to be established through the revision of the Capital Requirements Directive, scheduled for 2009. But this attempt is likely to fail, for the same reasons.

In spite of the reservations of several member states, the creation of a new EU-level authority is the only way to establish credible cross-border supervision in Europe.

As for supervision of cross-border groups at global level, the G20 can only create what exists already: exchanges of information on a voluntary basis between public bodies of different continents, without any effective supranational authority. Whether one likes it or not, this is a reality that is not about to change.

Nicolas Véron is a research fellow at Bruegel.
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