TRAVERS SMITH

Financial Services and Markets

A new European supervisory framework

The European Parliament has today approved a package of radical reforms to the supervision of financial services businesses in Europe. Implementing the new framework will involve a "root and branch" overhaul of financial supervision, with the creation of powerful new European institutions to whom national supervisors and, in some instances, firms themselves will be directly answerable. It is a significant move towards the increasing "Europeanisation" of financial services regulation.

The new framework must now be formally approved by the Council of the European Union (the Council). Since the Council has already (in early September) endorsed the legal texts, the expectation is that it will give its formal approval without debate. Steps can then be taken to implement the framework – there is a powerful political imperative for this to happen quickly.

What is the purpose of the reforms?

The legislation approved today is the result of more than a year of debate between the European Commission, the European Parliament and the Council. The reforms are intended to strengthen supervision of the financial sector in Europe by addressing perceived weaknesses in the supervisory response to the financial crisis.

What is going to change?

The FSA (or its successor(s)) will continue to supervise UK authorised firms at a national level. At a European level, however, the following new bodies will be created:

- The **European Systemic Risk Board (ESRB)**, which will be responsible for "macro-prudential supervision". It will:
    - monitor and assess risks to the financial system as a whole;
    - issue early warning alerts of potential systemic risks; and
    - make recommendations for action to address those risks.

- The **European System of Financial Supervisors (ESFS)**, which will be responsible for "micro-prudential supervision". National supervisors (including the FSA) will work with three new **European Supervisory Authorities (ESAs)**:
    - The **European Banking Authority (EBA)**;
    - The **European Securities and Markets Authority (ESMA)**; and
    - The **European Insurance and Occupational Pensions Authority (EIOPA)**.

The ESAs: "Watchdogs with a bite"

The ESAs will replace the existing Level 3 committees (namely, the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)). The ESAs will also have considerably wider and more intrusive powers than do CESR, CEBS and CEIOPS currently. In particular, the ESAs will have powers to:

- "police" national supervisors' implementation of EU law. If a requirement derived from an EU Regulation is not properly implemented, the ESAs can issue instructions to the relevant national supervisor. If those instructions go unheeded, the ESAs can **directly instruct financial institutions** to remedy any breach.

- impose, at their own initiative, mediation in the event of disputes between national supervisors. If the national supervisors do not then reach agreement, the ESAs will be able to **impose supervisory decisions directly on any financial institutions concerned**.

- impose **temporary bans or restrictions on particular financial products or activities** and request the Commission to legislate for a permanent ban.
- **investigate particular types of financial institution, product or activity** to assess the risks they pose to the financial markets, and (where necessary) issue warnings.
- develop draft technical standards with a view to moving towards a "**single European rulebook**".

Potential future developments: even more extensive powers for Europe?

The Commission will be required to report to the European Parliament and the Council every three years on whether the three ESAs should be integrated into a single supervisor for banking, securities, pensions and insurance and (if not) whether they should be headquartered in one city. Crucially, the Commission must also report on whether the ESAs should be granted additional supervisory powers (notably, in relation to pan-European financial institutions). It would therefore seem that a key purpose of the new framework is to provide a mechanism by which direct supervisory powers may increasingly be granted to European institutions over the coming years.

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