

A crisis is a terrible thing to waste

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The EU seems to be incapable of drawing the necessary lessons from the financial crisis. In its proposals on financial supervision, it is attempting to accommodate the demands of most member states, without implementing a truly integrated system of financial supervision. The core of its proposals for European supervision places a huge responsibility on the colleges of supervisors for cross-border banks, as if this model has not proven its complete inadequacy over the last few months. If Europe is serious about tackling the crisis and wants to be seen as such, it needs to make proposals for a European system of financial supervisors, **not** a network. This means empowering a strong centre which can, following the principle of subsidiarity, effectively and unequivocally act on behalf of the European interest and police national supervisory authorities.

Now, almost two years into the worst financial crisis in Europe's recent history, it seems that not much has changed. The proposals under discussion would basically upgrade the existing supervisory committees into three executive agencies of the European Commission, dealing with banking, insurance and securities markets. A fourth entity would be created under the aegis of the European Central Bank to monitor systemic risk. The creation of four different entities immediately poses problems of operational efficiency, information sharing and capacity to act. In addition, there is also the question about the supervision of firms that do not immediately fall within one of the four sectors, such as clearing and settlement operators, credit rating agencies, hedge funds, etc. Most importantly, the agencies would not have authority over the member states, but would help to execute EU policies.

The discussion about the impossibility to subject European banks to stress tests just emphasises how urgent it is to upgrade the European structure, and how much time has been wasted in recent months. The debate in the US took place over several weeks, with the results published on May 6th, including detailed information about the capital needs per bank. Meanwhile, following weeks of silence, the European banking supervisors announced on May 12th that they were working on a stress test for the European banking sector. And when the European communiqué came, it was disappointing – rather than proposing a stress test, it merely offered a general financial stability assessment. The analysis per bank remains the responsibility of the national supervisors, the communiqué noted.

This reaction to the financial crisis remains far too restrained, especially concerning action at the European level. Despite claims that banks were going European and that they would take the EU market as their home market, this prospect seems hardly to have materialised in the face of adversity. A European stress test cannot be performed, since there is no effective supervision at

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European level, but only consolidated supervision according to the rules of the home country. Moreover, the definition of non-performing loans differs from one member state to another: in certain states, it is 3 months overdue, in others 6. And an off-balance sheet vehicle is consolidated in some member states, but not in others. Given such variations in norms, how can a European-wide stress test possibly be implemented?

In the United States, contrary to the expectations of the European authorities, stress tests did not lead to more stress, the markets reacted positively to the increased transparency, confirming the adage of former US Supreme Court Justice Louis Brandeis: "Sunlight is the best disinfectant." Meanwhile, Europe muddles through, and has the audacity to publish a communiqué that it is carrying out a stress test, which it is not. What the Committee of European Banking Supervisors (CEBS) is doing is a macro financial stability assessment, and not a stress test. Individual stress tests are the responsibility of the home country, it was added, but the results will remain confidential. This condition would not change under the proposals put forward by the European Commission on May 27th.

If the IMF is asking Europe to carry out stress tests, it is repeating an old request. As early as June 2007, well before the financial crisis erupted, it asked the EU to improve the cooperation amongst supervisors and to upgrade the structure of supervision of market developments. Two years later, in the midst of the crisis, Europe is still struggling with the same question.

The danger is not imaginary that the level of European market integration that had been achieved in recent years will recede, which will reduce the sustainability of European monetary policy. The enormous amounts of state aids funneled into the financial sector over the last months (about 25% of the EU GDP) has come only from national sources, not from European. The criteria that were set differed from country to country, but finally, the objective was the preservation of *national* financial stability, not European. Moreover, the differences between national plans create enormous distortions at European level. State aids allowed certain banks to expand their European activities, whereas competitors did not have access to the same funds. To increase control over national markets, it has been suggested that greater restrictions should be imposed on banks wishing to operate through branches and that preference should be given to separately capitalised subsidiaries, as recommended in the Turner Report. We are back in the pre-1992 era of European financial market regulation.

It is thus extremely urgent to make progress towards a more European form of supervision. This should permit authorities to organise and publish stress tests from a European perspective, to allow those who kept the banks alive to judge whether the money was well spent. The concretisation of the de Larosière proposals is thereby crucially important, but the problem is that without a change of the EU Treaty, it is difficult to elaborate a European supervisory structure that stands above the member states and that can serve the European interest.