EU Financial Market Supervisory Architecture

Professor Anna Jurkowska-Zeidler,
Chair of Financial Law
Faculty of Law and Administration
Gdansk University

The financial supervisory legal framework

- The current regulatory system in the EU is based on the principle of home country control combined with maximum standards and mutual recognition.
- A financial institution is thus authorized and supervised in its home country and can expand throughout the EU by offering cross-border services in other EU Member States or establishing branches in these countries without additional supervision by host country authorities (home country control).

2

The financial supervisory legal framework

- The host country has to recognize supervision from the home country authorities (mutual recognition), as maximal requirements for prudential supervision have been laid down in the respective EU Directives (single standards) + EU Regulations (Single rulebook).
- However, financial institutions also operate through subsidiaries (separate legal entities) in other countries . These subsidiaries are separately licensed and supervised by the host country authorities.

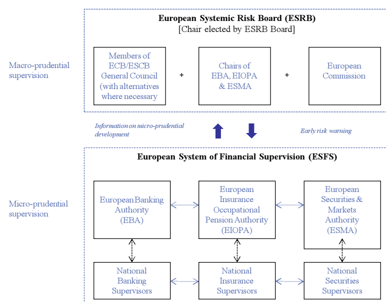
3

Does Regulatory/Supervisory Structure Matter?

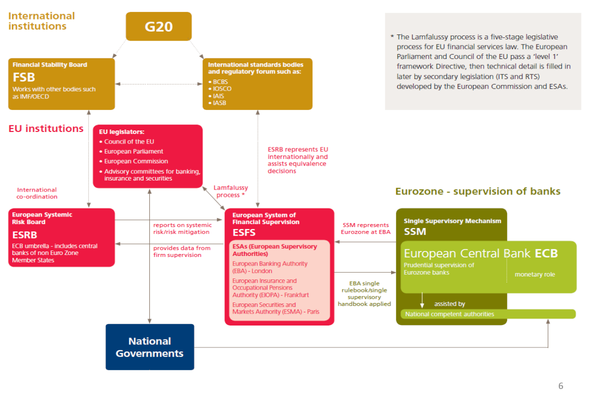
- No regulatory/supervisory structure can guarantee against bank crises
- However, legislation should make provision for handling crises and resolving bank/investment firm failures
- In the - FSA was institutionally dominated by a conduct of business ethos, causing it to lose focus on prudential and financial stability issues
  - Europe: 3 European Supervisory Authorities & ESRB
  - Australia: Twin Peaks (APRA & securities regulator)
  - Canada: Central bank, bank supervisor, provincial securities regulators
  - USA: Fed, Financial Oversight Council and multiple regulators
  - Switzerland: Swiss Financial Market Supervisory Authority (FINMA) and Swiss National Bank
  - Other single regulators: Germany/BaFin, Sweden, Japan, & South Korea

4

EU financial supervisory architecture



International financial supervisory architecture



EU financial supervisory architecture

- The new European financial supervisory framework started at the beginning of 2011.
- Three new European Supervisory Authorities are created to strengthen financial supervision at the EU level.
- These new European Supervisory Authorities (ESAs) have to work in tandem with the national financial supervisors, who remain responsible for day-to-day financial supervision.
- Financial supervision is still pre-dominantly nationally based in the European Union. Each country has its own financial supervisory authorities.

7

EU financial supervisory architecture

- While the new European framework is still based on the *sectoral model*, several EU Member States are adopting the *twin peaks model* (with two separate supervisors for micro-prudential supervision and conduct of business) or the *integrated model* (with one single supervisor) in response to the cross-sector developments of financial markets and institutions.

8

Sectoral model of supervision

- All countries used to have a sectoral model of financial supervision with separate supervisors for banking, insurance, and securities reflecting the traditional dividing lines between financial sectors
- Because of the blurring of the dividing lines between financial sectors, cross-sector models of supervision have emerged.
- There are two main cross-sector models of supervision: a functional (or 'twin peaks') model and an integrated model

9

'Twin peaks' model of supervision

- In the functional model, there are separate supervisors for each of the supervisory objectives: prudential supervision and conduct of business.
- Referring to these two objectives, the functional model is also known as the 'twin peaks' model.
- Jurisdictions such as the United Kingdom, the Netherlands, South Africa and Australia have substantially reformed their banking and financial sector regulators by adopting a 'twin peaks' regulatory structure.
- In some countries, especially in the euro area where central banks have transferred their responsibility for monetary policy to the ECB, the central bank is responsible for prudential supervision. In other countries a separate agency is responsible for prudential supervision

10

UK 'Twin Peaks' Approach

2013 UK replaces FSA with two new regulatory/supervisory authorities

- **Bank of England -** protecting and enhancing the stability of the UK financial system, working with other bodies (BoE, PRA, FCA & Treasury), special resolution regime; clearing & settlement; payment system
- **Financial Policy Committee (FPC) – macro-prudential oversight.** Identifying and monitoring systemic risks and taking action to remove or reduce them (including through directions and recommendations to the PRA and FCA) and devising macro-prudential tools
- **Prudential Regulatory Authority (PRA) -** prudentially regulating banks, insurers and complex investment firms; objective of safety and soundness of individual firms
- **Financial Conduct Authority (FCA) -** protecting and enhancing confidence in financial services and markets, including by protecting consumers and promoting competition; can use financial product banning orders

11

'Single' model of supervision

- In the integrated model, there is a single supervisor for banking, insurance and securities combined (or, put differently, one supervisor for prudential supervision and conduct of business combined).
- The integrated model combines the objectives of prudential supervision and conduct of business supervision, leaving systemic supervision (financial stability) as a separate function that is usually performed by the central bank

12

The organizational structure of financial supervision

Source: 2011 D. Schoenmaker Financial supervision in the EU

Countries	**Basic models**			
	(1) Sectoral	**(2) Cross-sector: Functional**	**(3a) Cross-sector: Integrated without central bank role in banking supervision**	**(3b) Cross-sector: Integrated with central bank role in banking supervision**
European Union	Bulgaria Cyprus Greece Lithuania Luxembourg Romania Slovenia Spain	Belgium (2011) France (2003/10) Italy (1999) Netherlands (2002) Portugal (2000) United Kingdom (2011)	Denmark (1988) Estonia (2002) Hungary (2000) Latvia (2001) Malta (2002) Poland (2008) Sweden (1991)	Austria (2002) Czech Republic (2006) Finland (2009) Germany (2002) Ireland (2003) Slovakia (2006)
Outside EU		Australia (1998) Canada (1987) United States (2010)	Japan (2000)	

13