

CSFI

CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

5 DERBY STREET
LONDON W1J 7AB

TEL: 020 7493 0173
FAX: 020 7493 0190

Rethinking the Lamfalussy process: A round-table discussion with Malcolm Levitt, Patrick Pearson (DG Markt), Paul Wright (FSA) and Didier Cahen (Eurofi) held on Wednesday, December 12, 2007, at the City Marketing Suite, Basinghall Street, London, EC2P 2EJ from 12:30-2:15pm.

Next year looks to be crucial for the review of the Lamfalussy Process overseeing financial regulation in Europe following the outcome of the recent Ecofin finance ministers meeting. The speakers saw two very different possible journeys it could take. The first speaker said Lamfalussy and its Level 3 (L3) committees were an improvement on what went before, there was a need for improvement but a single regulator or rulebook was not the answer. While convergence was a sound aim it should be convergence of outcomes not processes. In fact many objections to the current system were “specious”, he said. The fact that, for example, there were more than 100 derogations on banking was driven by the fact Lamfalussy was never meant to be a legislative body. Likewise it was silly to criticise delays in L3 without acknowledging politically-driven delays in L1 and L2.

A major issue is concern over financial stability. The first speaker said this could be broken down into depositors, shareholders and overarching stability concerns. Depositors were covered by the Depositors Protection Directive, which might need fine-tuning but did not need overhaul. Shareholders took on risk and could not expect a bailout. On overall stability, there was no sign of any cross-border institution in distress and supervisors were talking to each other. There was no reason why an EU supervisory body would have more foresight but would be less accountable to taxpayers.

The speaker said Ecofin should be seen as settling the debate. He highlighted three contentious issues. The first was its call to clarify the work of L3 committees, which he interpreted as tidying up rather than an overhaul. The second was a recommendation for qualified majority voting (QMV) with an emphasis on the non-binding nature of their decisions. The third was an invitation to L3 committees to transmit their work programmes to the Commission, Parliament and Ecofin for comment – which he saw as ruling out an opportunity for those bodies to lay down directions to L3.

The second speaker said there had been real progress of supervisory co-ordination. However any proposals for change should be answered on a case-by-case basis having regard to the size of the market, the type of business and the comparative advantage of different regulators. On crisis management it was vital to separate it from supervision. Here one must know who speaks to whom, how information is shared, what powers exist and seek clarity on dealing with liquidity and solvency.

The L3s needed strengthening but were not flawed, he said. The most pressing need was for behavioural change by committee members who should become more assertive and challenging. To further this there should be a “tough” peer review mechanism with public

criticism and a system of “comply or explain” where governments should explain why they were not implementing a measure.

The third speaker took a different tack. Prudential regulation and supervision of cross-border financial groups was fragmented – a bank operating in 10 countries needed approval in 10 different systems. One should do away with the hundreds of options and add-ons available to governments and that requires legislation. As Charlie McCreevy said on 4 December the regulatory framework was still based on a national system that was “frankly out of date” in regard to the structure of the largest financial bodies. Institutions should be subject to prudential rules applied in a similar fashion across the board.

The speaker said the recent financial crisis had shown while the ECB acted well there was no sharing of information, communication or meetings between regulators. There is an urgent need to ensure co-ordination between supervisors. He said supervisors of cross-border groups should have an explicit mandate to assess local issues on a group wide perspective; information of liquidity and solvency should go to all national authorities; these authorities should match their methods to suit the specific features of the company. Ecofin was welcome but it needed political impetus. That time was now.

The fourth speaker said Brussels-watchers must use Kremlin-ology analysis to understand the Ecofin communiqué. It posed three tough challenges to the Commission. The first was to invite the Commission to “clarify the role of the L3s” and “consider all different options” to strength their workings. The second was for L3s to “explore the possibilities” to strengthen the application of their guidelines etc. The third was to “introduce the possibility to apply QMV”. All these were code words for politicians seeking a range of options to choose from during 2008.

He said the Commission did not see the need for a radical overhaul, as change would be divisive and paralysing. No one wanted to change the Treaty. On the issue of crisis management, the Commission has made clear Northern Rock held lessons for Europe, in particular the level of communication between the UK and Ireland and Denmark, each of which had a branch in their country, in terms of the Chancellor’s 100% deposit guarantee. What would have happened if it were a larger, more systemically important bank? Would there have been an identical reflex across, for example, France, Spain and the UK? April’s Ecofin will discuss the L3 issues - the game is not over. He said any belief December’s Ecofin had resolved these issues was “complacent assumption making”. However the second speaker said issues such as Barings showed the reflex was well understood. Reform was fine but the idea of a formulaic request for information from 62 bodies would be a “nightmare”.

One member said regulation was surely not the answer – three banks in highly-regulated UK and Germany had almost collapsed. More regulation was not the answer given the role Basel played in encouraging off-balance sheet operations. Another said the 1985 tin crisis showed a burden-sharing formula was not the problem but the lack of any actual burden sharing. Overall it seems 2008, in which France will hold the presidency in the second half, will be key for the Lamfalussy process and that in the wake of Northern Rock, the UK’s voice may not be as listened to as in the past.